91-1451

Supreme Court, U.S.
FILED
MAR 9 1992
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No._____

IN THE

Supreme Court of the United States

October Term, 1991

MESA PETROLEUM CO., et al.,

Petitioners,

v.

DAVID COLAN and UNOCAL CORPORATION,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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March 6, 1992

QUESTION PRESENTED

This case presents a single question under § 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78p(b), which provides that, for the purpose of preventing speculative abuse of inside information by corporate officers, directors and more-than-10% stockholders, any profit from such a person's "purchase" and "sale" of a corporation's equity securities within a period of less than six months is recoverable by the corporation:

Is an economically coerced exchange, pursuant to a corporation's recapitalization, of equity securities for debt securities by a more-than-10% stockholder (which never had access to inside information) an "unorthodox transaction" with no potential for speculative abuse of inside information and, therefore, not a "sale" for purposes of § 16(b) (as Petitioner Mesa claims and the District Court held); or is it instead a § 16(b) "sale" that may be matched against a market purchase of stock within the prior six months (as Respondent Unocal claims and the Court of Appeals held)?

PARTIES TO THE PROCEEDING

The petitioners are Mesa Petroleum Co., Mesa Southern Co., Mesa Asset Co., CY-41, Inc., and JACK-41, Inc.* The respondents are David Colan and Unocal Corporation.

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* The following information is provided pursuant to Rule 29.1 of this Court. Mesa Petroleum Co. (which was the parent company of Mesa Southern Co., which was in turn the parent company of Mesa Asset Co.) has been succeeded by Mesa Inc. Mesa Inc. is a publicly held corporation, the only non-wholly owned subsidiary of which is Clean Fuels, Inc. CY-41, Inc. and JACK-41, Inc. have no parent companies or subsidiaries.

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Petitioners Mesa Petroleum Co., Mesa Southern Co., Mesa Asset Co., CY-41, Inc., and JACK-41, Inc. (collectively, "Mesa") respectfully pray that a writ of certiorari issue to review the order and amended opinion of the United States Court of Appeals for the Ninth Circuit, entered in this proceeding on December 23, 1991.

OPINIONS BELOW

The opinion of the Court of Appeals for the Ninth Circuit, reversing the District Court's grant of summary judgment for Mesa and directing the District Court to grant summary judgment for Unocal, is to be reported at 951 F.2d 1512. App. 3a.[1] This opinion amended and superseded that court's previous opinion, reported at 941 F.2d 933. The opinion and order of the United States District Court for the Central District of California, entering summary judgment for Mesa and denying summary judgment for Unocal, is unreported. App. 36a.

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[1] References to the Appendix are cited "App. __a"

JURISDICTION

The decision of the Court of Appeals was originally entered on August 8, 1991. On December 23, 1991, the Court of Appeals denied a timely petition for rehearing and rejected a timely suggestion for rehearing en banc. App. 7a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

This case involves the application and interpretation of § 16(b) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78p(b), which provides in pertinent part:

> (b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer . . . .

The phrase "beneficial owner" is defined in § 16(a) of the 1934 Act, 15 U.S.C. § 78p(a), as "[e]very person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any [registered] equity security. . . ." The full text of § 16(a) and (b) is set forth at App. 64a. With respect to the terms "purchase" and "sale," § 3(a) of the 1934 Act, 15 U.S.C. § 78c(a)(13), (14), provides:

> When used in this chapter, unless the context otherwise requires —
>
> . . . .
>
> (13) The terms "buy" and "purchase" each include any contract to buy, purchase, or otherwise acquire.
>
> (14) The terms "sale" and "sell" each include any contract to sell or otherwise dispose of.

STATEMENT OF THE CASE

This case is the final vestige of a 1985 contest for control of Unocal that involved a hostile tender offer by Mesa, a bitter public relations campaign, a proxy fight, acrimonious litigation in several courts and a highly coercive defensive recapitalization by Unocal that ended the contest.

In early 1985, Mesa acquired more than 10% of Unocal's common stock. From the start, Mesa's relationship with Unocal was characterized by "unmitigated hostility." App. 50a. At no time did Mesa have access to any inside information whatsoever about Unocal. In April 1985, Mesa commenced a cash tender offer for Unocal shares, seeking to acquire control of Unocal.

Unocal responded immediately by proposing a defensive recapitalization.[2] The recapitalization was structured as an exchange offer (the "Exchange Offer") of newly created Unocal bonds for about half of Unocal's outstanding shares of common stock. In form, each stockholder could decide whether or not to exchange his shares. But the economics were such that any stockholder who did not participate would suffer severe financial injury — an immediate reduction of about 40% in the value of his Unocal investment.[3] Unocal warned its stockholders of these conse-

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[2] A defensive recapitalization typically involves an exchange of cash or debt securities (or both) by the target company for its own common stock, with a commensurate increase in debt accompanied by liens on assets or other restrictive covenants, all intended to make the target company less desirable and to make the tender offeror abandon its efforts. *See* 1 A. Fleischer, *Tender Offers: Defenses, Responses, and Planning* 388.172-81 (Supp. 1987). A recapitalization can be effected by means of an exchange offer, a merger or stockholder-approved charter amendments. *Id.* at 388.180.

[3] The $72 in bonds that Unocal offered for each share of stock to be exchanged was far above the then-current stock value of $49 per share. It was generally anticipated by the trading markets, and specifically intended by Unocal, that this reallocation of value from Unocal equity to Unocal debt would instantly drive the post-transaction market value

quences in a prospectus that contained more than 100 printed pages of financial and other disclosures.

To make the Exchange Offer as lethal to Mesa as possible, Unocal provided that Mesa, alone among all its stockholders, would not be allowed to exchange any of its shares for bonds. Thus, if the Exchange Offer had been completed as originally structured, the value of Mesa's Unocal investment would have plummeted 40%.[4]

Mesa considered (and rejected) the possibility of seeking to mount a tender offer for the Unocal shares that would remain outstanding after the Exchange Offer.[5] Mesa filed actions in both federal and state court trying, unsuccessfully, to stop the Exchange Offer or to invalidate the provision excluding Mesa. Mesa's final challenge failed on May 17, 1985, when the Delaware Supreme Court ruled that Unocal could consummate the Exchange Offer and exclude Mesa. In light of the dire financial consequences of being left out of the Exchange Offer, Mesa

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of the remaining shares of stock down to about $30 per share, or almost 40% less than the pre-transaction $49 value. A stockholder who participated in the recapitalization would end up with a combination of (1) Unocal bonds (valued at $72 for each share he exchanged) plus (2) half of his original shares of Unocal stock (valued at an expected $30 per share) — yielding a "blended" value of about $51 per original share (i.e., ½ × $72 plus ½ × $30). (Unocal later reduced the exchange percentage to about one third.) The value of a non-participating stockholder's shares would fall immediately to about $30 per share.

[4] In Mesa's case, this would have been a decrease in value of about $450 million (i.e., a $19 per share decrease on 23.7 million shares).

[5] Although Mesa argued below that the record did not support (and indeed contradicted) the conclusion that the possibility of such a tender offer had in fact been realistic, Mesa does not seek review by this Court of the Ninth Circuit's conclusion that such an alternative was, as a factual matter, a viable "choice" available to Mesa. App. 24a-25a. *See* Part IV, *infra*, regarding the legal relevance of this "choice."

concluded that its only realistic alternative was to abandon its efforts to acquire Unocal in return for Unocal's granting it the right to participate in the Exchange Offer like all other stockholders. On May 20, 1985, Unocal agreed to let Mesa participate in the Exchange Offer, subject to Mesa's abandoning its tender offer and signing an onerous "standstill" agreement.[6] Accordingly, Mesa exchanged a portion of its Unocal common shares for Unocal bonds. Mesa later sold these bonds, which as debt securities were not subject to § 16(b), for cash.

In June 1986, David Colan, a Unocal stockholder, filed this case on behalf of Unocal in the District Court, invoking jurisdiction under § 27 of the 1934 Act, 15 U.S.C. § 78aa. Unocal, originally a nominal defendant, was subsequently realigned as a plaintiff.[7] The lawsuit seeks disgorgement under § 16(b) by Mesa to Unocal of alleged short-swing profits, plus pre-judgment interest, of about $150 million.

Mesa moved for summary judgment arguing, in reliance on *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973) (*"Kern County"* or *"Kern"*), that its exchange of Unocal stock for Unocal bonds in the economically coercive Exchange Offer was an unorthodox transaction with no possibility for speculative abuse of inside information and, therefore, not a "sale" for purposes of § 16(b). Unocal also moved for summary judgment, arguing that the exchange was a § 16(b) "sale." On April 10, 1990, the District Court granted Mesa's motion and denied Unocal's.

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[6] The standstill agreement prohibited Mesa from purchasing any additional Unocal stock for 25 years. In addition, since Mesa would still be Unocal's largest stockholder following the recapitalization (owning about the same percentage of outstanding shares it owned beforehand), Unocal used the agreement to impose strict controls on Mesa's ability to vote or sell the Unocal shares it retained.

[7] Unless the context otherwise requires, the term "Unocal" as used herein means both David Colan and Unocal Corporation.

On August 8, 1991, the Court of Appeals for the Ninth Circuit reversed the summary judgment for Mesa and directed the District Court to grant Unocal's cross-motion for summary judgment. On December 23, 1991, the Court of Appeals denied Mesa's petition for rehearing and rejected its suggestion for rehearing en banc.[8]

Concluding that Mesa's exchange was factually distinguishable from the transaction in *Kern County* because it was (1) not pursuant to a merger and (2) not an "involuntary" transaction, the Court of Appeals held that the exchange was a § 16(b) "sale." The Court of Appeals further stated that, as a result of its "determination that this exchange was not an 'unorthodox transaction,' we do not review the record to determine whether the Mesa Defendants had the opportunity to engage in the speculative abuse of inside information." App. 34a.[9]

On January 7, 1992, the Court of Appeals granted Mesa's motion for stay of the mandate. App. 63a.

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[8] If the decision below is allowed to stand, a trial will be required on issues not presented in this petition, including whether Mesa's March 1985 acquisition of 6.7 million Unocal shares (which increased Mesa's ownership from 9.7% to 13.6%) was effected in a single purchase or multiple purchases. *See Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232 (1976) (holding acquisition that results in ownership of more than 10% not a § 16(b) "purchase"). Whatever the outcome of those other issues might be, it would not affect whether the question presented here is worthy of certiorari, since it would not remedy the substantial confusion in the law concerning the important and recurring issue of "unorthodox transactions" under § 16(b), confusion that is exacerbated by the Court of Appeals' decision.

[9] Mesa does not seek review of the Court of Appeals' rejection of Mesa's argument regarding the nature of the proceedings before the District Court. Contrary to the suggestion in the Ninth Circuit's opinion, App. 17a, however, Mesa argued below that the District Court's judgment should have been affirmed on appeal whether reviewed on a summary judgment standard or on a "clearly erroneous" standard.

REASONS FOR GRANTING THE WRIT

The question presented concerns the proper application of this Court's analytical approach to "unorthodox transactions" under § 16(b), as set forth in Justice White's landmark opinion in *Kern County*. The Ninth Circuit's decision (which is supported by decisions of the Fifth, Seventh and Eleventh Circuits) conflicts with numerous decisions of the Second Circuit and with decisions of the Fourth, Sixth and Eighth Circuits.

Presented with facts strikingly parallel to those of *Kern County*, the Ninth Circuit nevertheless concluded that *Kern* was inapplicable both because Mesa exchanged securities in a recapitalization rather than a merger and because Mesa's exchange was "voluntary" rather than "involuntary."[10] In both respects, the Ninth Circuit's decision conflicts with decisions of the Second and other Circuits. If the Court does not grant the writ, the law regarding "unorthodox transactions," an important and recurring issue[11] under an important section[12] of the 1934 Act, will be left in substantial confusion.

On the broader issue of federal statutory construction, the Ninth Circuit has departed from the analytical approach employed by this Court and by the Second Circuit in recent cases, not involving unorthodox transactions, that have construed key statutory terms in §16(b) and other sections of the 1934 Act in context and in light of the purpose of the statutory provision.

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[10] In the course of denying the rationale of *Kern County*, the Ninth Circuit's opinion circumscribed *Kern* as merely a "fact-specific" case, App. 22a, and dismissed a frequently cited statement in *Kern* because this Court "did not cite any authority to support [it]." App. 32a-33a. *See* Part III, *infra*.

[11] *Kern County* is perhaps the most significant decision under §16(b) and has been cited in more than 100 cases.

[12] *Gollust v. Mendell*, 111 S. Ct. 2173, 2178 (1991) (describing §16(b) as "an important part of Congress' plan in the 1934 Act" to insure fair and honest trading markets).

Indeed, the conflicts presented here with Second Circuit decisions applying the unorthodox transaction approach and otherwise construing §16(b) terms are so numerous and direct that, without question, had this case been filed in that Circuit, the result would have been different.

If the decision below is allowed to stand, Mesa could be saddled with a judgment for $150 million, even though it could not possibly have engaged in the speculative abuse of inside information — the sole and specific evil that §16(b) is designed to prevent. Such a windfall for Unocal would serve no statutory or other legitimate purpose.

I. *Kern County's* Analytical Approach to §16(b)

Section 16(b) establishes a "flat rule"[13] that any profits realized by a statutory insider from the "purchase" and "sale" of an issuer's equity securities within six months are recoverable by the issuer. In sharp contrast with other provisions of the federal securities laws that deal with misuse or misstatement of information,[14] §16(b) requires no proof of scienter, reliance, causation, misrepresentation or materiality. Instead, if (1) a "purchase" and (2) a "sale" by (3) a statutory insider took place (4) within six months, §16(b) is applied "mechanically" to require "automatic" disgorgement of any profit. In most instances, therefore, application of §16(b) is simple, giving the rule its intended and stringent deterrent effect. *See generally* 5 L. Loss & J. Seligman, *Securities Regulation* 2331-36 (3d ed. 1990).

On the other hand, this "automatic" aspect of §16(b) does not eliminate the judicial function in deciding what the statute means. Courts long ago began to interpret the critical statutory terms

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[13] *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 422 (1972).

[14] *E.g.*, Rule 10b-5 under §10(b) of the 1934 Act, 15 U.S.C. §78j(b), 17 C.F.R. §240.10b-5; Rule 14a-9 under §14(a) of the 1934 Act, 15 U.S.C. §78n(a), 17 C.F.R. §240.14a-9; §14(e) of the 1934 Act, 15 U.S.C. §78n(e).

"purchase" and "sale" in light of the statutory purpose unambiguously stated in §16(b) itself:

> For the purpose of preventing the *unfair use of information* which may have been *obtained* by such beneficial owner, director, or officer *by reason of his relationship to the issuer*. . . .

(emphasis added). Well before *Kern County*, the Ninth Circuit had concluded that §16(b)'s "exceedingly general" terms "purchase" and "sale" should be interpreted in light of the statute's purpose "to avoid purposeless harshness." *Blau v. Max Factor & Co.*, 342 F.2d 304, 306-07 (9th Cir.), *cert. denied*, 382 U.S. 892 (1965). As the Second Circuit put it, "[t]here is no rule so 'objective' ('automatic' would be a better word) that it does not require some mental effort in applying it on the part of the person or persons entrusted by law with its application." *Blau v. Lamb*, 363 F.2d 507, 520 (2d Cir. 1966) (construing §16(b)), *cert. denied*, 385 U.S. 1002 (1967).

This Court's decision in *Kern County* endorsed the 20-year trend of *Max Factor, Lamb* and other decisions. *See* 411 U.S. at 594 n.26 (citing five such cases with approval and endorsing their "pragmatic" approach).[15] *Kern*, like its predecessors, recognized that many "borderline" or "unorthodox" transactions — as opposed to "garden-variety" or "traditional cash-for-stock" transactions — could not possibly be used for the speculative abuse of inside information[16] that Congress sought to prevent and thus

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[15] For a discussion tracing the development of §16(b) law from the "simplistic," "mechanistic" approach of older cases through the unorthodox transaction cases ultimately endorsed in *Kern County*, see *Abrams v. Occidental Petroleum Corp.*, 450 F.2d 157, 162-63 (2d Cir. 1971) (Friendly, C.J.), *aff'd sub nom. Kern County*.

[16] "Inside information" about an issuer, of course, is nonpublic information about the business and affairs of the issuer, as distinguished from both public information about the issuer and nonpublic information that is not about the issuer (e.g., information about the objectives and plans of one of its stockholders). *See, e.g., Merrill Lynch, Pierce,*

should not be deemed "purchases" or "sales" within the scope of § 16(b). *Id.* at 591-95. The "unorthodox transaction" approach is the analytical framework within which transactions are scrutinized to determine whether they present an opportunity for speculative abuse of inside information:

> In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent — the realization of short-swing profits based upon access to inside information — thereby endeavoring to implement congressional objectives without extending the reach of the statute beyond its intended limits.

Id. at 594 (footnote omitted).

Consistent with the aspect of § 16(b)'s "flat rule" that truly is mechanical, the unorthodox transaction doctrine does not require the courts to address the often difficult fact issue of whether inside information was *in fact used* in connection with a purchase or sale. Instead, the doctrine holds that a transaction does not constitute a "purchase" or "sale" for § 16(b) purposes (whether or not it is a purchase or sale for other purposes) when — as here — the circumstances are such that the defendant *could not possibly* have used or benefitted from any inside information.[17] For to hold the nominal "insider" liable in the latter case would be punishment without purpose, which Congress (as evidenced by

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Fenner & Smith, Inc. v. Livingston, 566 F.2d 1119, 1122-23 (9th Cir. 1978); *Heublein, Inc. v. General Cinema Corp.,* 559 F.Supp. 692, 702-03 (S.D.N.Y.), *aff'd,* 722 F.2d 29 (2d Cir. 1983), *cert. denied,* 465 U.S. 1066 (1984).

[17] Reaching a conclusion to this effect, however, rarely requires a court to resolve disputed fact issues. Since the meaning of statutory terms is a question of law for the courts, the overwhelming majority of cases applying the unorthodox transaction approach under § 16(b), including *Kern* itself and almost all such cases cited herein, have been disposed of by summary judgment or at the pleading stage.

the statutory words) did not intend. *Cessante ratione legis, cessat et ipsa lex.*[18]

Not only has *Kern County* been the law for almost 20 years, but its analytical approach to interpreting the terms "purchase" and "sale" under § 16(b) is entirely consistent with recent decisions of this Court interpreting other statutory terms under other sections of the 1934 Act. These decisions have focused both on the statutory purpose of the particular section at issue and on the language of § 3(a) of the 1934 Act, which defines various terms used in the Act, including "purchase" and "sale,"[19] but introduces and explicitly qualifies every such term with the phrase "unless the *context* otherwise requires" (emphasis added). For example, in *Reves v. Ernst & Young,* 494 U.S. 56 (1990), construing another 1934 Act term, members of this Court observed that § 3(a)'s "context clause" leaves it to the judiciary to "harmonize . . . facially rigid terms . . . with the evident intent of Congress," *id.* at 75-76 (Stevens, J., concurring), and "to flesh out . . . 'context clause' exceptions." *Id.* at 81 (Rehnquist, C.J., concurring in part and dissenting in part). *See also Marine Bank v. Weaver,* 455 U.S. 551, 556 (1982) (noting that specified definitions may not apply if context otherwise requires). The Ninth Circuit's decision contravenes the analytical approach of these more recent decisions of this Court, as well as *Kern County*.

Similarly, the Ninth Circuit's decision conflicts with the analytical approach that the Second Circuit has applied in recent

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[18] *See, e.g., Blau v. Lamb,* 363 F.2d 507, 516 (2d Cir. 1966) (construing § 16(b); cited with approval in *Kern,* 411 U.S. at 594 n.26), *cert. denied,* 385 U.S. 1002 (1967).

[19] Section 3(a) does not, though, provide comprehensive definitions of these two terms. Virtually all other subsections of § 3(a) state that the term X *"means"* Y, but §§ 3(a)(13) ("purchase") and 3(a)(14)("sale") simply state that the term purchase (or sale) *"includes"* a contract to purchase or otherwise acquire (or to sell or otherwise dispose of). *See S.E.C. v. National Sec., Inc.,* 393 U.S. 453, 466 (1969) (describing § 3(a) as "for the most part unhelpful" in determining appropriate meanings of "purchase" and "sale" for purposes of § 10(b) of 1934 Act).

§ 16(b) cases interpreting terms other than "purchase" and "sale." *See Mendell v. Gollust,* 909 F.2d 724, 728 (2d Cir. 1990) ("We and most other courts have developed a 'pragmatic' approach, construing §16(b) in a manner that seems most consistent with Congress' purpose."), *aff'd,* 111 S.Ct. 2173 (1991); *C.R.A. Realty Corp. v. Crotty,* 878 F.2d 562, 566-67 (2d Cir. 1989) (using "functional" approach to construe term "officer" under §16(b) to include only those with "potential access to inside information"). *Cf. International Controls Corp. v. Vesco,* 490 F.2d 1334, 1343-45 (2d Cir.) (holding spin-off of securities a "sale" for § 10(b) purposes even though not a "sale" for § 16(b) purposes), *cert. denied,* 417 U.S. 932 (1974).

II. The Ninth Circuit's Decision Ignores the Close Factual Similarity Between This Case and *Kern County*

The undisputed facts of this case are overwhelmingly, indeed strikingly, parallel to those of *Kern County*. The factual differences, *see* App. 24a (characterizing this case as "factually distinguishable" from *Kern*), are immaterial in light of the fundamental rationale of *Kern*. In *Kern,* Occidental Petroleum had made a hostile tender offer for common stock of Old Kern. Like Mesa, Occidental was a true outsider (although it eventually owned 20% of Old Kern's stock) with absolutely no access to any inside information about Old Kern. *Kern County, passim.* Old Kern's management, like Unocal's, vigorously opposed the hostile offer. 411 U.S. at 598. To defeat Occidental's offer, Old Kern agreed to merge into Tenneco, with new preferred stock of Tenneco to be issued in exchange for Old Kern common stock. *Id.* at 599. The new Tenneco shares, like the Unocal bonds here, were to be freely tradeable.

When the merger agreement was announced, Occidental had several alternatives. It could have sold its Old Kern stock in the market (as Mesa could have done with its Unocal stock), but as this Court noted, that sale would have unquestionably resulted in §16(b) liability and thus was not a "realistic alternative." *Id.* at 599. Or Occidental could have made a higher tender offer for Old

Kern shares or otherwise attempted to frustrate Old Kern's defensive strategy with a proxy fight or legal challenge. Here, Mesa's legal challenges to Unocal's Exchange Offer failed, as had its earlier proxy fight. Mesa also considered (and rejected) the possibility of seeking to mount a tender offer for additional Unocal shares to compete with Unocal's Exchange Offer. After reviewing its alternatives, Occidental, like Mesa here, decided to abandon its takeover efforts and entered into settlement discussions with its adversary. *Id.* at 587.

In the concluding paragraph of its analysis, the Ninth Circuit emphasized that Mesa "voluntarily" sought to persuade Unocal to permit Mesa to participate in the Exchange Offer and "shrewdly calculated [its] options." App. 34a. But this does not distinguish Mesa's predicament from Occidental's; the Exchange Offer was engineered not by Mesa, but by Unocal for the very purpose of frustrating Mesa's efforts. *See* 411 U.S. at 599 ("That merger was not engineered by Occidental but was sought by Old Kern to frustrate" Occidental's takeover efforts). Once the Delaware Supreme Court had ruled against Mesa on May 17, 1985, Unocal had the absolute right to proceed with the Exchange Offer and to exclude Mesa from participating in it. The "negotiations" that Mesa and Unocal then had which resulted in the May 20, 1985 agreement permitting Mesa to participate concerned, not the terms of the Exchange Offer, but the terms of Mesa's capitulation. App. 11a-12a.

Moreover, in *Kern County*, Occidental "took ... steps to protect itself," 411 U.S. at 587, including voluntarily (and presumably "shrewdly") negotiating a separate option agreement with Tenneco, an arrangement available only to it and not to other Old Kern stockholders. *Id.* Upon signing the option agreement and receiving a substantial cash payment therefor, Occidental publicly announced that it supported the Old Kern-Tenneco merger, *id.* at 587-88, and even authorized its shares to be voted in favor of the transaction if its votes were needed to obtain the requisite majority. *Id.* at 616 (Douglas, J., dissenting).

Occidental's "plight" was hardly as "hapless" as the Ninth Circuit suggested. *See* App. 27a. Occidental's chief executive described his company's $17 million profit from his dealings with Old Kern and Tenneco as " 'not bad for two weeks' work.' " 411 U.S. at 617 n.23 (Douglas, J., dissenting). That Mesa's chief executive characterized the financial outcome of the transaction as a "victory" for Mesa, App. 27a, is equally irrelevant under the *Kern County* analysis.

Applying the unorthodox transaction analysis articulated in Part II of the opinion to these facts, *Kern County* held, in Part III, that Occidental's disposition of stock in the merger was not a "sale" for purposes of § 16(b) and, in Part IV, that its execution of the option agreement was not a § 16(b) "sale" either.[20]

Here, though, the Ninth Circuit ignored the factual parallels of this case with *Kern County*. Instead, it emphasized two differences: (1) the transaction here was a recapitalization in the form of an exchange offer, not a merger like the transaction at issue in

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[20] In holding that the execution of the option agreement (which by its terms related to the Tenneco stock Occidental would receive in the merger) did not constitute a § 16(b) "sale" of Occidental's Old Kern stock, the Court rejected two independent arguments advanced by the plaintiff. Most of Part IV of *Kern* deals with the Court's analysis under the unorthodox transaction approach:

> [W]e do not find in the execution of the Occidental-Tenneco option agreement a sufficient possibility for the speculative abuse of inside information with respect to Old Kern's affairs to warrant holding that the option agreement was itself a "sale" within the meaning of § 16(b).

411 U.S. at 601. The Court noted that even though Occidental wanted the option to avoid being a minority stockholder in Tenneco and Tenneco wanted to rid itself of a potentially troublesome minority stockholder, "[m]otivations like these do not smack of insider trading." *Id.* In the last paragraph of Part IV, the Court rejected the plaintiff's second argument, that the option was an option in form but a sale in fact. *Id.* at 603-04.

Part III of *Kern*, and (2) Mesa's disposition was "voluntary," because it "negotiated" the right to participate in the coercive Exchange Offer and because participation in an exchange offer (even an economically coercive exchange offer) requires a "voluntary" act on the part of the stockholder, whereas a merger does not.

III. The Ninth Circuit's Limitation of the Unorthodox Transaction Analysis to Mergers Conflicts with *Kern County* and with Decisions of the Second Circuit Applying That Analysis to Recapitalizations

The Court in *Kern County* did not attempt to articulate a precise, all-encompassing definition of the term "unorthodox" transaction (or its sometime substitute, "borderline" transaction). The term entered the § 16(b) lexicon simply as a short-hand device for differentiating transactions that are not "traditional cash-for-stock" transactions (the phrase used, e.g., in *Kern*, 411 U.S. at 593) or "garden-variety" transactions (the phrase used, e.g., in *Abrams v. Occidental Petroleum Corp.*, 450 F.2d 157, 162 (2d Cir. 1971), *aff'd sub nom. Kern County*).

Nevertheless, the Court did state in *Kern's* oft-cited footnote 24 that the term "unorthodox transaction" had been applied to "stock conversions, *exchanges pursuant to* mergers and *other corporate reorganizations*, stock reclassifications, and dealings in options, rights, and warrants." 411 U.S. at 593 n.24 (emphasis added) (citing 2 L. Loss, *Securities Regulation* 1069 (2d ed. 1961)[21]). Here, Unocal's Exchange Offer was a recapitalization — a recognized form of corporate reorganization[22] — of

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[21] This treatise, in turn, at 1069-72, discussed several of the early unorthodox transaction cases.

[22] *See, e.g.*, H. Henn & J. Alexander, *Laws of Corporations* § 386 at 1161-62 (3d ed. 1983) (noting that "term 'reorganization' . . . under state law is sometimes used as a synonym for recapitalization or reclassification of shares"); *Microdot, Inc. v. United States*, 728 F.2d 593 (2d Cir. 1984) (holding exchange offer of new debt securities for

Unocal, and thus squarely within the listing enumerated in *Kern's* footnote 24. Mesa's disposition in the Exchange Offer was obviously not a "garden-variety" or "traditional cash-for-stock" transaction.

The Ninth Circuit, however, confined *Kern County* to mergers. App. 29a. ("We conclude that the *facts in this matter* do not come within the holding of *Kern County* that an involuntary transaction that results from a *merger* is 'unorthodox.' " (emphasis added)).[23] Further, the Ninth Circuit dismissed the listing of unorthodox transactions in *Kern's* footnote 24 as irrelevant, stating that "the [Supreme] Court did not cite any authority to support [it]." App. 32a-33a.[24]

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a portion of corporation's common stock to be a "reorganization" under § 368 of the Internal Revenue Code and, more specifically, a "recapitalization" under § 368(a)(1)(E)).

[23] *See also, e.g.*, App. 24a (this case "factually distinguishable" from *Kern* because "Unocal did not merge"); App. 29a (*Kern* "simply held that an automatic exchange . . . pursuant to a merger" is not covered by §16(b)). The Ninth Circuit also stated that the "majority" of the transactions that have been considered unorthodox under the "exception announced" in *Kern County* were exchanges pursuant to mergers, App. 29a, thus implicitly acknowledging that other courts have applied *Kern* to non-merger transactions — and presumably suggesting that those "minority" courts went beyond *Kern*.

Even if the Ninth Circuit's decision is narrowly read as a holding that a recapitalization (and/or a tender offer or exchange offer) must always be a § 16(b) "sale," its holding conflicts with the rationale of *Kern*, and its numerous statements limiting *Kern* to mergers demonstrate that that holding was reached by applying a highly flawed approach to § 16(b) that conflicts with the approach mandated by *Kern*.

[24] In contrast, the Tenth Circuit has interpreted footnote 24 as a meaningful list of types of unorthodox transactions, and the Fifth and Seventh Circuits have (in dicta) characterized footnote 24 as a *nonexhaustive* listing thereof. *Morales v. Mapco, Inc.*, 541 F.2d 233, 235 (10th Cir. 1976) (holding transaction in warrants "unorthodox" because encompassed by footnote 24), *cert. denied*, 429 U.S. 1053

But it is plain that this Court in *Kern* did not limit the unorthodox transaction approach to mergers. Part IV of *Kern* applied the unorthodox transaction approach to the option granted by Occidental and concluded it was not a § 16(b) "sale." In Part II of the opinion, where the Court set forth an overview of its analytical approach before applying that approach to the two transactions at issue in Parts III and IV, the Court (1) included footnote 24, listing various types of transactions that had been deemed unorthodox; and (2) cited five earlier Court of Appeals decisions — *not one* of which involved a merger — as examples of the unorthodox transaction approach.[25]

In addition, the Ninth Circuit's decision conflicts with two decisions of the Second Circuit applying the unorthodox transaction approach to an exchange in a recapitalization. *Rothenberg v. United Brands Co.*, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶96,045 (S.D.N.Y.), *aff'd without opinion*, 573 F.2d 1295 (2d Cir. 1977);[26] and *Roberts v. Eaton*, 212 F.2d 82

(1977); *Texas Int'l Airlines v. National Airlines, Inc.*, 714 F.2d 533, 539 n.9 (5th Cir. 1983) (describing footnote 24 as a "nonexhaustive list"), *cert. denied*, 465 U.S. 1052 (1984); *Oliff v. Exchange Int'l Corp.*, 669 F.2d 1162, 1166 (7th Cir. 1980) (noting that *Kern* applies to " 'unorthodox,' or perhaps a broader class of 'borderline' transactions"; citing footnote 24), *cert. denied*, 450 U.S. 915 (1981).

[25] 411 U.S. at 594 n.26 (citing *Roberts v. Eaton*, 212 F.2d 82 (2d Cir.) (exchange of stock in recapitalization, which was initiated at behest of insider), *cert. denied*, 348 U.S. 827 (1954); *Ferraiolo v. Newman*, 259 F.2d 342 (6th Cir. 1958) (economically coerced conversion), *cert. denied*, 359 U.S. 927 (1959); *Blau v. Max Factor & Co.*, 342 F.2d 304 (9th Cir.) (voluntary exchange of one class of equity security for another), *cert. denied*, 382 U.S. 892 (1965); *Blau v. Lamb*, 363 F.2d 507 (2d Cir. 1966) (voluntary conversion of preferred stock into common), *cert. denied*, 385 U.S. 1002 (1967); and *Petteys v. Butler*, 367 F.2d 528 (8th Cir. 1966) (economically coerced conversion), *cert. denied*, 385 U.S. 1006 (1967)).

[26] The Second Circuit's holding in *Rothenberg* was dismissed by the Ninth Circuit on the ground that the exchange there did not result in a

(2d Cir.) (cited with approval in *Kern County*, 411 U.S. at 594 n.26), *cert. denied*, 348 U.S. 827 (1954).[27] Other courts have also, since *Kern*, applied its analysis to hold numerous types of transactions, other than mergers, to be unorthodox.[28]

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change in "either the character of the investment or the nature of the market risk assumed," in contrast to Mesa's exchange. App. 33a. But the district court opinion in *Rothenberg* said only that absent such a change, there was not a "sale." It did not say, as the Ninth Circuit concluded, that the presence of such a change ipso facto yields a "sale" within the scope of § 16(b). That proposition, in addition to being a non sequitur, would contravene *Kern County*, where Occidental exchanged common stock of one company for preferred stock of another.

[27] In *Roberts*, a combination of new preferred stock and new common stock was exchanged, pursuant to a plan approved by stockholder vote, for previously outstanding common stock. 212 F.2d at 83. The opinion termed the transaction a "reclassification," *id.*, a term now more commonly used for changes in the par value of an outstanding class of stock. *See, e.g.*, R. Balotti & J. Finkelstein, *Delaware Law of Corporations and Business Organizations* § 8.4 (2d ed. 1990).

[28] Other types of transactions that courts have labeled unorthodox under *Kern County* include: (1) cash tender offer — *Pier 1 Imports of Georgia, Inc. v. Wilson*, 529 F. Supp. 239, 243 (N.D.Tex. 1981); (2) recapitalization — *Hayes v. Sampson*, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,693 (S.D.N.Y. 1980); (3) exercise of options — *Pay Less Drug Stores v. Jewel Cos.*, 579 F. Supp. 1396, 1400-01 (N.D. Cal. 1984); (4) liquidation — *Bolton v. Gramlich*, 540 F. Supp. 822, 841 (S.D.N.Y. 1982); (5) exercise of stock appreciation rights — *Matas v. Siess*, 467 F. Supp. 217, 221 (S.D.N.Y. 1979); (6) sale of stock option rights — *Rosen v. Drisler*, 421 F. Supp. 1282, 1286 (S.D.N.Y. 1976); (7) open market transaction in warrants — *Morales v. Mapco, Inc.*, 541 F.2d 233, 235 (10th Cir. 1976), *cert. denied*, 429 U.S. 1053 (1977); (8) overissuance of shares — *Kay v. Scientex Corp.*, 719 F.2d 1009, 1012 (9th Cir. 1983); and (9) underwriting of warrants — *Portnoy v. Seligman & Latz, Inc.*, 516 F. Supp. 1188, 1197-98 (S.D.N.Y. 1981).

IV. The Circuits Are in Conflict over Both the Necessity for and the Meaning of "Involuntariness" as an Element of the *Kern County* Analysis

The Ninth Circuit's decision exacerbates a substantial conflict among the Circuits, including the Second Circuit, over the treatment of "involuntariness" under the unorthodox transaction analysis.

A. The Circuits Are in Conflict over Whether "Involuntariness" Is a Necessary Element Under *Kern County*

The Ninth Circuit concluded that the critical element of the *Kern County* analysis was the "involuntary" and "automatic" nature of the merger transaction at issue there. App. 24a, 29a. And indeed, the Court stated in *Kern* that "the involuntary nature of Occidental's exchange [in the merger], when coupled with the absence of the possibility of speculative abuse of inside information, convinces us that § 16(b) should not apply to transactions such as this one." 411 U.S. at 600.

Yet much of the *Kern* opinion suggests that the critical issue in the Court's analysis was not "involuntariness," but rather the absence of opportunity for speculative abuse of inside information. The option transaction that *Kern* held not to be a "sale" was entirely voluntary. Three of the five pre-*Kern* unorthodox transaction cases cited with approval in footnote 26 of *Kern* involved wholly voluntary transactions; [29] the other two were voluntary in form but economically coerced.[30] Footnote 24 of *Kern County*

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[29] 411 U.S. at 594 n.26 (citing *Roberts v. Eaton*, 212 F.2d 82 (2d Cir.) (exchange in recapitalization initiated and controlled by insider), *cert. denied*, 348 U.S. 827 (1954); *Blau v. Max Factor & Co.*, 342 F.2d 304 (9th Cir.) (voluntary exchange), *cert. denied*, 382 U.S. 892 (1965); and *Blau v. Lamb*, 363 F.2d 507 (2d Cir. 1966) (voluntary conversion), *cert. denied*, 385 U.S. 1002 (1967)).

[30] *Ferraiolo v. Newman*, 259 F.2d 342 (6th Cir. 1958) (economically coerced conversion), *cert. denied*, 359 U.S. 927 (1959); *Petteys v.*

includes other transaction forms that are by definition purely voluntary in form (conversions and dealings in rights and warrants). 411 U.S. at 593 n.24. Nowhere did *Kern* say that "involuntariness" is essential to unorthodoxy. In contrast to *Kern's* single use of the word "involuntary," 411 U.S. at 600, Appendix E hereto presents eight excerpts from the *Kern County* majority opinion that refer to the impossibility of speculative abuse of inside information.[31] App. 66a-67a.

The fundamental thrust of the *Kern* analysis, based on the opinion as a whole, is directed at the impossibility of speculative abuse of inside information and is best summarized in the following:

> In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire *whether the transaction may serve as a vehicle for the evil which Congress sought to prevent — the realization of short-swing profits based upon access to inside information.* . . .

411 U.S. at 594 (emphasis added).[32] Thus, the absence of opportunity for speculative abuse by a defendant in a transaction might be demonstrated not only by "involuntariness," but alternatively by the defendant's lack of access to inside information and/or by other characteristics of the transaction (such as the fact that a reorganization or other corporate transaction was equally available to all stockholders, was not initiated or con-

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Butler, 367 F.2d 528 (8th Cir. 1966) (same), *cert. denied*, 385 U.S. 1006 (1967).

[31] The phrase "inside information" appears 20 times in the majority opinion in *Kern*. The word "automatic" never appears.

[32] In another § 16(b) case three years later, the Court described its holding in *Kern* with no mention of involuntariness: "[In *Kern County*] we held that an '*unorthodox transaction*' in securities that did not present the *possibility of speculative abuse* of inside information was not a 'sale' within the meaning of § 16(b)." *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S 232, 237 (1976) (emphasis added).

trolled by the defendant, was accompanied by full disclosure of information by the corporation to its stockholders and/or resulted in no change in the stockholders' relative percentage ownership interests).[33]

Other Circuits have reached conflicting conclusions about whether "involuntariness" is essential under *Kern*. *Compare Texas Int'l Airlines v. National Airlines, Inc.*, 714 F.2d 533, 540 (5th Cir. 1983) (holding a voluntary transaction to be a "sale" under § 16(b) even though the 10% stockholder defendant had no access to inside information and thus could not have engaged in speculative abuse), *cert. denied*, 465 U.S. 1052 (1984),[34] *and Super Stores, Inc. v. Reiner*, 737 F.2d 962 (11th Cir. 1984) (holding a voluntary disposition in a tender offer to be a § 16(b) "sale" even though the tender offer was available to all stockholders and was not controlled by the insider), *with Gold v. Sloan*, 486 F.2d 340, 346 (4th Cir. 1973) (holding a disposition in a merger not to be a "sale" under *Kern County* as to defendant Scurlock, who had no access to inside information, even though he cast the deciding vote to approve the merger), *cert. denied*, 419 U.S. 873

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[33] Such factors (sometimes singly, sometimes in combination) are common threads through the cases that have applied the unorthodox transaction approach, both before and after *Kern*. *See, e.g.*, the cases cited in notes 25 and 28, *supra*.

[34] *Texas International*, however, should not be read to stand for the overly general proposition ascribed to it by the Ninth Circuit, viz., that a disposition "in the face of defeat in a takeover contest . . . is not an 'unorthodox transaction' under *Kern County*." App. 30a. The defendant in *Texas International* was indeed a defeated tender offeror. But the transaction at issue there was not a disposition in a tender offer (coercive or otherwise); it was a garden-variety cash-for-stock transaction available only to the 10% stockholder who sold. The defendant's argument there, which the Fifth Circuit rejected, was that such a transaction should not be a § 16(b) "sale" for the sole reason that the *defendant* was a defeated tender offeror who had no access to inside information. In contrast, Mesa's argument here turns on the nature of the *transaction*, as well as the status of the defendant.

(1974),[35] *and Colan v. Continental Telecom, Inc.*, 616 F. Supp. 1521 (S.D.N.Y. 1985) (holding voluntary grant of option by defeated corporate suitor with no access to inside information not to be a § 16(b) sale), *aff'd without opinion*, 788 F.2d 2 (2d Cir. 1986).[36]

B. Whether "Involuntariness" Is Considered a Necessary Element or Merely a Sufficient Element, the Ninth Circuit's Analysis Thereof Conflicts with the Analysis in *Kern County* and with Decisions of the Second, Sixth and Eighth Circuits

"Involuntariness" (i.e., the absence of realistic alternatives to the transaction at issue) has been a characteristic of many transactions held to be outside the scope of § 16(b), both before and after *Kern County*. Whether it is deemed a necessary element under the unorthodox transaction analysis or, instead, simply one of several potential indicia that a transaction provided

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[35] In the same case, the Fourth Circuit held that the disposition in the merger by defendant Sloan *was* a § 16(b) "sale" because, unlike Scurlock, he had access to inside information. 486 F.2d at 352-53.

[36] For a discussion of the difficulty courts have had with this question, see *Portnoy v. Seligman & Latz, Inc.*, 516 F. Supp. 1188, 1194-95 (S.D.N.Y. 1981):

> [T]he Court [in *Kern County*] suggested several factors to consider . . . [in the analysis]: access to inside information, the voluntariness of the transaction, and the possibility of speculative abuse . . . .
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> . . . .
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> . . . [B]ecause of the variety of statements in *Kern County*, lower courts cannot be certain how to evaluate the factors mentioned in relation to one another. "The Court did not specify which findings . . . are necessary, and which sufficient, to yield the conclusion that a given transaction lies outside the purview of section 16(b)."

(quoting Note, *Exceptions to Liability Under Section 16(b): A Systematic Approach*, 87 Yale L.J. 1430 (1978)).

no opportunity for speculative abuse, its analytical significance is that it demonstrates that a transaction provided no opportunity for speculative abuse of any inside information the defendant might have had. Here, however, the Ninth Circuit (relying in part on a decision of the Seventh Circuit) applied a three-part analysis of the term that conflicts with the concept of involuntariness used in *Kern* itself, with three decisions of the Second Circuit and with decisions of the Sixth and Eighth Circuits.

First, the Ninth Circuit concluded that Mesa's disposition was "voluntary" because Mesa "voluntarily" negotiated with Unocal seeking participation in the Exchange Offer. App. 25a, 34a. But in *Kern,* Occidental voluntarily negotiated its option agreement — and did so to *improve* its position vis-a-vis other Old Kern stockholders, not, as Mesa did here, to eliminate discrimination against it. *See* Part II, *supra.* This Court said Occidental's motivation "d[id] not smack of insider trading," 411 U.S. at 601, and held that neither the grant of the option nor the disposition in the merger was a "sale." *Accord Colan v. Continental Telecom, Inc.,* 616 F. Supp 1521, 1528 (S.D.N.Y. 1985) (holding option agreement negotiated by defeated corporate suitor with no access to inside information not to be a § 16(b) "sale"), *aff'd without opinion,* 788 F.2d 2 (2d Cir. 1986).

Second, the Ninth Circuit concluded that Mesa's disposition was "voluntary" because it had the alternative "choice" of holding its Unocal stock and making another tender offer for additional shares. App. 24a-27a. The Second Circuit, however, has twice held that such a "choice" is not relevant under § 16(b). In *Abrams,* the Second Circuit decision affirmed in *Kern,* Judge Friendly specifically rejected the relevance of such a choice, which was available to Occidental:

> We fail to see the possibility of speculative abuse in a situation where such an offeror simply declines to make a still higher offer or to attempt to block a transaction which it regards as advantageous to all the shareholders *including itself.*

Abrams v. Occidental Petroleum Corp., 450 F. 2d 157, 163 (2d Cir. 1971) (emphasis added), *aff'd sub nom. Kern County*. The Second Circuit reached the same conclusion in *American Standard, Inc. v. Crane Co.*, 510 F.2d 1043, 1055 (2d Cir. 1974), *cert. denied*, 421 U.S. 1000 (1975):

> We hold that whether the tender offeror quits fighting when the defensive merger is announced or continues to fight in the hope of winning, his exchange of stock on the merger after he has been defeated is not *ipso facto* a "sale" for § 16(b) purposes.

There, the Second Circuit emphasized the tender offeror's "inability . . . to affect the course of the target company" in holding the transaction not to be a "sale." 510 F.2d at 1055.

Third, the Ninth Circuit concluded that Mesa's disposition was "voluntary" because it had the "alternative" of simply holding its Unocal shares (notwithstanding the consequent reduction in share value of 40% for any stockholder who did so, or $450 million in Mesa's case), and thus the court rejected Mesa's argument that a transaction voluntary in form is "involuntary" in substance if it is economically coerced. App. 28a-29a. In this respect, the Ninth Circuit's holding conflicts with decisions of the Sixth and Eighth Circuits holding that economically coerced transactions are "involuntary" for purposes of the unorthodox transaction analysis. *Ferraiolo v. Newman*, 259 F.2d 342 (6th Cir. 1958), *cert. denied*, 359 U.S. 927 (1959); *Petteys v. Butler*, 367 F.2d 528 (8th Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967).[37] Both of

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[37] In *Ferraiolo*, convertible preferred stock was "called" by the corporation for redemption at $27 per share in cash. Each preferred share was convertible by the holder into a certain number of common shares, which at the time of the call had an aggregate market value that had risen to $36 per preferred share. The insider chose to convert his preferred into the more valuable common, rather than let it be liquidated into cash by operation of contract on the redemption date. According to the court, the insider's conversion — even though voluntary in form — "was in a very real sense involuntary" since his (or any holder's) failure to convert would have resulted in a loss of

these decisions were cited with approval in *Kern* on the very subject of "alternatives," 411 U.S. at 600, as well as for being seminal cases in the development of the unorthodox transaction doctrine. *Id.* at 594 n.26.[38] *See also Provident Sec. Co. v. Foremost-McKesson, Inc.*, 506 F.2d 601, 605 (9th Cir. 1974) (suggesting that inability to avoid §16(b) liability "without serious detriment" would constitute involuntariness under *Kern* analysis), *aff'd on other grounds*, 423 U.S. 232 (1976).

On the other hand, the Ninth Circuit found support for its conclusion regarding economic coercion in *Oliff v. Exchange International Corp.*, 669 F.2d 1162 (7th Cir. 1980), *cert. denied*, 450 U.S. 915 (1981). There the Seventh Circuit held that a reacquisition of shares was a § 16(b) "purchase" even though it

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about 25% of the value of the investment. Thus the Sixth Circuit held the transaction not to be within the scope of § 16(b). 259 F.2d at 346. *Petteys* involved substantially identical facts (insiders were forced to convert "rather than suffer a needless and substantial economic loss," again about 25% of the value of the investment), and the Eighth Circuit held to the same effect. 367 F.2d at 537. Here, every Unocal stockholder confronted an automatic, immediate 40% decrease in the value of his shares if he failed to participate in the Exchange Offer.

[38] Unocal argued to the Ninth Circuit that the promulgation of Rule 16b-9, 17 C.F.R. § 240.16b-9, under § 16(b) relegated *Ferraiolo* and *Petteys* to mere "historical significance," since by that rule the Securities and Exchange Commission exempted certain conversion transactions from the application of § 16(b). Yet these two cases were among the five cases cited by the Court in *Kern* as principal examples of the unorthodox transaction doctrine. 411 U.S. at 594 n.26. Rule 16b-9 was promulgated in 1966, seven years before *Kern*, and this Court was aware of the rule when it decided *Kern*. *See* 411 U.S. at 612 (Douglas, J., dissenting). The promulgation of Rule 16b-9 did not override or eliminate the analytical force or precedential value of *Ferraiolo* and *Petteys*; it merely relieved the courts, even before *Kern County*, of the burden of deciding cases in this one area of unorthodox transactions. *See* 411 U.S. at 612 (Douglas, J., dissenting) (acknowledging continued significance of these cases).

was motivated by the defendant's desire to avoid paying a tax of 205% of its earlier sale price.

After ignoring the striking similarity of this case to *Kern*, confining *Kern* to mergers, and concluding that "involuntariness" (as narrowly defined by it) was necessary and had not been shown, the Ninth Circuit concluded its opinion by stating that "we do not review the record to determine whether the Mesa Defendants had the opportunity to engage in the speculative abuse of inside information." App. 34a. Thus the Ninth Circuit never even considered — on the fundamental thrust of the *Kern* test — the fact that the transaction in question was one in which there was no possibility for speculative abuse by the defendant.

Numerous characteristics of the transaction — in addition to the undisputed fact that Mesa, a true outsider, had no *access* to inside information — establish that there would have been no *opportunity* for speculative abuse of inside information by Mesa even if it had received any. Unocal's Exchange Offer was initiated and controlled by Unocal, not Mesa. It was a transaction available to all of Unocal's stockholders, not just Mesa. It was accompanied by full disclosure of information by Unocal to all stockholders. It was economically coercive to all stockholders.

V. The Insider Trading and Corporate Takeover Aspects of This Case Underscore Its Importance

In weighing the importance of the question presented by this petition, it is of particular significance that § 16(b) is one of the two principal federal weapons against insider trading, along with § 10(b)'s Rule 10b-5. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. Because § 16(b) is drawn with greater precision than Rule 10b-5, under which the law is largely judge-made, and also because § 16(b) gives the Securities and Exchange Commission exemptive authority, the courts have not played as great a role under § 16(b) as under Rule 10b-5. Nevertheless, the hundreds

of reported § 16(b) cases attest to the very substantial role that the courts have played in the development of the section.[39]

This Court's decision in *Kern County,* which has now been in the books for almost two decades, may well be the most important of any of these cases in its endorsement of the "unorthodox" transaction doctrine. That endorsement has brought a measure of certainty into counsel's advisory task. But the conflicts described above, unless resolved, severely undermine *Kern County*. The Ninth Circuit's decision turns the clock back to pre-*Kern* days and adds substantial confusion to § 16(b) law.

Stability is particularly important in the law affecting corporate takeovers, where the transactions, which often determine the allocation of huge amounts of capital and other resources, have a tremendous impact on the national economy. And history clearly shows that takeovers are a substantial and frequently recurring phenomenon, not only during the mid- and late 1980s, but also over the long term.[40]

If the Ninth Circuit's decision stands, a statute designed to deter short-swing purchase and sale combinations by classic company insiders will have become a weapon for incumbent management to use as a deterrent against any further purchase of stock by any 10% stockholder disfavored by management (who is

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[39] The application of § 16(b) liability to 10% stockholders has received particular focus. Three of the five cases decided by this Court under § 16(b) have resolved liability questions in favor of a 10% stockholder in a takeover or acquisition context. *Foremost-McKesson, Inc. v. Provident Sec. Co.,* 423 U.S. 232 (1976); *Kern County; Reliance Electric Co. v. Emerson Elec. Co.,* 404 U.S. 418 (1972). The Court's other § 16(b) cases are *Gollust v. Mendell,* 111 S.Ct. 2173 (1991) (interpreting standing requirements), and *Blau v. Lehman,* 368 U.S. 403 (1962) (holding partnership not liable for trades by partner).

[40] *See, e.g.,* S.E.C. Advisory Comm. on Tender Offers, *Report of Recommendations* 11 n. 9 (July 8, 1983) (setting forth number of reported tender offers per year, 1965 through 1982, and citing earlier studies).

thus a de facto outsider despite being a de jure insider). Any such stockholder must fear that if he purchases more shares, a hostile management will be able, at least in the Ninth Circuit, to structure an economically coercive transaction that will create "profits" for all stockholders but then immediately recoup the 10% stockholder's share for the company, leaving him and him alone economically punished. That is not the purpose of § 16(b).

If not reconciled by this Court, the sharp conflicts described herein among the Circuits — especially those between the Ninth Circuit and the Second Circuit — will encourage substantial forum shopping. Forum shopping is particularly likely because of the nationwide service of process and broad choice of venue available under the 1934 Act and because § 16(b) questions lend themselves so readily to declaratory judgment actions by the insider.[41]

The decision of the Court of Appeals collides with *Kern County,* with numerous decisions of the Second Circuit and with decisions of three other Circuits. It confuses the law. It is retrogressive. It embraces — indeed all but revels in — an "automatic" and "mechanical" (App. 21a.) interpretation of § 16(b) that produces "purposeless harshness."[42] It should not be allowed to stand.

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[41] Both *Foremost-McKesson,* 423 U.S. 232, and *Reliance Electric,* 404 U.S. 418, for example, were declaratory judgment actions.

[42] *See Blau v. Max Factor & Co.,* 342 F.2d 304 (9th Cir.), *cert. denied,* 382 U.S. 892 (1965).

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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March 6, 1992

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Appendix A

FOR PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

DAVID COLAN, *Plaintiff,* and UNOCAL CORPORATION, *Plaintiff-Appellant,* v. MESA PETROLEUM CO., et al., *Defendants-Appellees.*	No. 90-55641 D.C. No. CV-86-3564-JGD
DAVID COLAN, *Plaintiff-Appellant,* and UNOCAL CORPORATION, *Plaintiff,* v. MESA PETROLEUM CO., et al., *Defendants-Appellees.*	No. 90-55643 D.C. No. CV-86-3564-JGD ORDER AND AMENDED OPINION

Appeal from the United States District Court
for the Central District of California
John G. Davies, District Judge, Presiding

Argued and Submitted
June 6, 1991—Pasadena, California

Filed August 8, 1991
Amended December 23, 1991

Before: Alfred T. Goodwin, Harry Pregerson and Arthur L. Alarcon, Circuit Judges.

Opinion by Judge Alarcon

SUMMARY

Securities

Reversing a district court judgment, the court of appeals held that the sale or purchase of common stock pursuant to a tender offer is a "sale" under section 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78p(b)) rather than an "unorthodox transaction" from which the issuer may not seek recovery of profits.

Appellees Mesa Petroleum Company and others (collectively, the Mesa defendants) acquired subtantial stock in appellant Unocal Corporation. Unocal initiated defensive measures to discourage the possibility of a takeover. Mesa continued acquiring common stock and informed the Securities and Exchange Commission that it might seek to obtain control over Unocal's operations. Mesa made a tender offer to purchase Unocal common stock. Unocal rejected the offer. Unocal then offered to exchange debt securities for outstanding Unocal common stock, expressly excluding Mesa from participating in the exchange offer. Negotiations to settle the dispute were unsuccessful. The Delaware Supreme Court upheld Unocal's right to exclude Mesa from the self-tender offer. Following further negotiations, Mesa entities were allowed to participate in Unocal's offer. Mesa exchanged shares of common stock for negotiable debt securities. A Unocal shareholder filed a derivative action on Unocal's behalf, alleging that the Mesa defendants violated section 16(b) and seeking recovery of Mesa's short-swing profits. Unocal joined the suit as a plaintiff. Mesa responded that the

exchange of stock for negotiable debt was not a sale because it fell within the "unorthodox transaction" defense to section 16(b) liability stated in *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973). Prior to trial, Unocal moved for an *in limine* ruling that the "unorthodox transaction" defense was not applicable. The parties agreed that the matter would be heard as a motion and cross motion for summary judgment and that the factual record on this issue was already fully developed. The court found in favor of the Mesa defendants, concluding that, although the transaction was a section 16(b) sale, the *Kern County* "unorthodox transaction" defense applied in this case.

[1] Mesa argued that the district court conducted a bench trial, not a hearing on cross motions for summary judgment, and that this court should therefore apply a clearly erroneous standard. [2] Because the record indicates that the district court decided the applicability of the "unorthodox transaction" defense in response to Mesa's request that the matter be treated as a motion for summary judgment, [3] the lower court's order was subject to de novo review on appeal.

[4] Section 16(b) provides that an issuer may recover profits realized by a beneficial owner from the sale of the issuer's equity securities within a six-month period. [5] A sale occurs when an insider becomes irretrievably entitled to receive a sum certain for his security. [6] In *Kern County*, the Supreme Court held that an exchange of stock was not a section 16(b) sale because of the involuntary nature of the exchange, which was required pursuant to the merger of two corporations. [7] This case is factually distinguishable because the exchange of stock for debt securities was not an involuntary or automatic transaction. [8] The Mesa defendants had a choice of participating in the offer or holding onto their stock. [9] They initiated arms-length negotiations with Unocal, seeking participation in the self-tender offer. [10] The record conclusively shows that the exchange of stock for negotiable debt was voluntary.

[11] The Mesa defendants argued that otherwise volitional transactions are unorthodox if a beneficial owner is coerced economically into exchanging his common stock. [12] An economic coercion test is contrary to the intent of Congress in enacting a bright-line, flat rule requiring disgorgement of profits. [13] The facts in this case do not come within the *Kern County* holding that an involuntary transaction resulting from a merger is unorthodox. [14] The sale or purchase of stock pursuant to a tender offer is not an unorthodox transaction.

[15] The Mesa defendants also argued that the exchange was an unorthodox transaction because it resulted from a recapitalization of Unocal. [16] *Kern County* did not involve recapitalization, and [17] other cases cited by the Mesa defendants do not support this argument.

COUNSEL

Darryl Snider, Brobeck, Phleger & Harrison, Los Angeles, California, for the appellant Unocal; William Lerach, Milberg, Weiss, Bershad, Specthrie & Lerach, San Diego, California, for the plaintiff-appellant David Colan.

James Edward Maloney, Baker & Botts, Houston, Texas, for the defendants-appellees.

ORDER

The opinion filed on August 8, 1991, is amended by deleting the following sentence:

> Once in control of Unocal, the Mesa Defendants would have the option of selling off Unocal's assets and thereby recouping any of their losses in the

value of the stock purchased prior to the self-tender offer.

Slip. op. at 10764.

With the opinion so amended, the panel has voted unanimously to deny the petition for rehearing. Judges Pregerson and Alarcon have voted to reject the suggestion for rehearing en banc, and Judge Goodwin recommends such rejection.

The full court has been advised of the suggestion for rehearing en banc and no judge of the court has requested a vote on the suggestion for rehearing en banc. Fed. R. App. P. 35(b).

The petition for rehearing is denied and the suggestion for rehearing en banc is rejected.

OPINION

ALARCON, Circuit Judge:

In this action for recovery of short-swing profits brought pursuant to section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), Unocal Corporation appeals from the denial of its cross motion for summary judgment, and the order granting a motion for summary judgment in favor of Mesa Petroleum Company, Mesa Southern Company, Mesa Asset Company, CY-41, Inc., and Jack-41, Inc. (Mesa Defendants). We must decide whether an exchange by a beneficial owner of its common stock for non-convertible debt securities, in response to a self-tender offer, is a "sale" within the meaning of section 16(b) of the Securities Exchange Act of 1934. We reverse because we have concluded that an exchange of common stock for a negotiable debt security pursuant to a self-tender offer is a "sale" within section 16(b).

Unocal's contentions on appeal can be summarized as follows:

> One. The district court erroneously weighed the evidence and made credibility determinations on ruling on cross motions for a summary judgment.
>
> Two. The district court erred in concluding that Mesa's exchange of Unocal common stock for negotiable debt securities in response to its self-tender offer was an "unorthodox transaction," and not a "sale" requiring a disgorgement by the Mesa Defendants of any profits that may have been realized as a result of this transaction.

PERTINENT FACTS

In October of 1984, Mesa Partners II was formed and began accumulating stock in Unocal. The general partners in Mesa Partners II were: (1) Mesa Asset Company, a wholly owned subsidiary of Mesa Southern Company, which is a wholly owned subsidiary of Mesa Petroleum Company; (2) Cy-41, Inc., wholly owned by Cyril Wagner, Jr.; and (3) Jack-41, Inc., wholly owned by Jack E. Brown.

Cyril Wagner, Jr., and Jack E. Brown are the sole partners of Wagner & Brown, and Brown & Wagner. Cyril Wagner, Jr., and Jack E. Brown, along with Brown & Wagner, are also the partners of Wagner & Brown II. T. Boone Pickens was the President and Chairman of the Board of Directors of Mesa Petroleum Company, President of Mesa Assets Company, and President of Mesa Southern Company. This joint venture shall be referred to as Mesa Partners II in this opinion.

On February 14, 1985, Mesa Partners II filed a Schedule 13D statement[1] with the Securities and Exchange Commission

[1]Section 13(d) of the Securities Exchange Act of 1934 requires any person who becomes a beneficial owner, directly or indirectly, of more than

(SEC), in which it reported that it had acquired 7.3 percent of Unocal's common stock for investment purposes. By February 22, 1985, Mesa Partners II owned 17 million shares of Unocal's common stock, representing 9.7 percent of the outstanding shares.

Unocal initiated defensive measures in order to discourage a perceived takeover threat by Mesa Partners II. On February 25, 1985, Unocal amended its bylaws concerning the procedures for nominating directors and making shareholder proposals. Unocal also filed an action in the Superior Court of the State of California for the County of Los Angeles against Security Pacific National Bank on March 12, 1985, for breach of fiduciary duty, breach of contract, and deceit and misrepresentation in connection with loans it made to Mesa Partners II. Mesa Partners II used the money obtained from these loans to purchase Unocal common stock. Mesa Petroleum Company and Mesa Asset Company responded by filing an action in the same court against Unocal on March 21, 1985, alleging wrongful interference with their banking relationships.

On March 27, 1985, Mesa Partners II acquired a total of 6.7 million shares of Unocal common stock at $48.10 per share. This transaction increased Mesa Partners II's shares to 23.7 million and its ownership interest to 13.6 percent of Unocal's common stock.

On March 28, 1985, Mesa Partners II amended its Schedule 13D statement. Mesa Partners II reported to the SEC that it "may seek to obtain control of the company or to participate in the formulation, determination or direction of the basic business decisions of the Company." Mesa Partners II also

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five percent of any class of equity security to file a statement of ownership with the Securities and Exchange Commission within ten days after reaching the five percent threshold. 15 U.S.C. § 78m(d)(1) (1988). *See also* 1 T. Hazen, *The Law of Securities Regulation* § 11.10 at 688 (2d ed. 1190).

indicated that it intended to solicit proxies to gain postponement of the annual Unocal shareholders meeting then scheduled for April 29, 1985.

On April 1, 1985, Unocal filed a complaint alleging violations of section 13(d) of the Securities and Exchange Act of 1934 against T. Boone Pickens, Jr., Cyril Wagner, Jr., Jack E. Brown, Mesa Partnership, the Partners and certain affiliates of the Partners in the United States District Court for the Central District of California. Unocal claimed that the named defendants or their agents made false and misleading representations in Mesa Partners II's original Schedule 13D statement by indicating that it acquired Unocal common stock for investment purposes. The defendants filed a counterclaim on April 12, 1985, alleging that Unocal violated proxy solicitation rules.

On April 8, 1985, Mesa Partners II made a tender offer to purchase 64 million shares of Unocal common stock at $54 per share.[2] Unocal's Board of Directors recommended that Unocal's shareholders reject Mesa Partners II's tender offer as inadequate and not in their best interests.

On April 16, 1985, Unocal offered to exchange "a package of its debt securities with an aggregate principal amount of $72 . . . consisting of (i) $20 principal amount of 14% Senior Secured Notes Due 1990, (ii) $32 principal amount of Floating Rate Senior Secured Notes Due 1991 and (iii) $20 principal amount of Senior Secured Extendible Notes Due 1997" for up to 87.2 million shares (approximately one-half) of Unocal's outstanding common stock. This offer was originally conditioned upon Mesa Partners II's "acceptance for payment of 64,000,000 Shares pursuant to the Mesa Offer." Unocal modified its offer on April 23, 1985, to provide for the purchase of "up to 50 million shares of its common stock in

[2]Mesa Eastern, Inc., a wholly owned subsidiary of Mesa Partners II, joined with Mesa Partners II in this tender offer.

exchange for $72 per share in senior secured notes, whether or not Mesa purchased the 64 million shares it was seeking through its tender offer."

Unocal stated in its offer that one of its express purposes was "to make it more difficult for Mesa Bidders to complete the Mesa Offer." Unocal expressly excluded Mesa Partners II from participating in its exchange offer. Unocal's exchange offer provided that

> [t]he Company [Unocal] will not accept for exchange, or issue Securities in exchange for, any Shares tendered by or on behalf of Mesa Petroleum, Mesa Partnership, Mesa Sub or any person controlling, controlled by or under common control with any of the foregoing (collectively, the "Mesa Group"), nor any Shares tendered by or on behalf of any other person that were transferred, directly or indirectly, after the date of this Offer to Purchase to such person by any member of the Mesa Group.

On April 22, 1985, Mesa Partners II challenged its exclusion from Unocal's tender offer in Delaware state court. On April 29, 1985, the Court of Chancery temporarily restrained Unocal from proceeding with its offer unless it included Mesa Partners II.

On May 14, 1985, representatives of Unocal and Mesa Partners II, including T. Boone Pickens, met in an attempt to negotiate a settlement. These discussions broke off without resolution. On May 17, 1985, the Delaware Supreme Court reversed the Court of Chancery and held that Unocal was not prohibited by law from excluding Mesa Partners II from its tender offer.

Following the Delaware Supreme Court's decision, representatives of Mesa Partners II contacted Unocal and sought to

reopen negotiations. After several rounds of negotiations, an agreement was reached on May 20, 1985.

Pursuant to the agreement, the "Mesa Entities" were allowed to participate in Unocal's self-tender offer.[3] Mesa Partners II agreed to terminate its tender offer. In addition, Mesa Partners II agreed that it would not participate in any proxy solicitation and would not acquire any additional Unocal shares for a period of twenty-five years. Mesa Partners II also agreed that, for a period of ten years, it would vote its Unocal stock on all matters in the same way and "in the same proportion as the votes cast by holders of Shares other than the Mesa Entities." In addition, Mesa Partners II agreed to strict controls on its ability to sell its Unocal common stock.

On the same date, Mesa Partners II exchanged approximately 7.8 million shares of Unocal common stock for negotiable debt securities.[4] Each of these securities had a stated maturity date and provided for periodic interest payments. Mesa Asset Company sold these debt securities on July 3, 1985, for approximately $589 million.

PROCEDURAL BACKGROUND

On June 3, 1986, David Colan, a shareholder in Unocal, filed a derivative action on behalf of Unocal, alleging violations of section 16(b) by the Mesa Defendants. The action sought recovery of short-swing profits realized by Mesa. Unocal was originally named as a defendant in this action, but was realigned as a real party plaintiff on August 3, 1989.

On September 25, 1989, the Mesa Defendants filed a

[3]The Mesa Entities included Mesa Petroleum Company, Mesa Asset Company, Mesa Partners II, Mesa Eastern, Inc., Cy-41, Inc., Jack-41, Inc., Cyril Wagner, Jr., Jack E. Brown, T. Boone Pickens, Jr., Wagner & Brown, Brown & Wagner, and Wagner & Brown II.

[4]Mesa Partners II was dissolved on May 20, 1985.

motion for summary judgment, in which they argued that the exchange of their common stock for Unocal's debt securities was not a sale within section 16(b). The Mesa Defendants argued that their exchange of stock for negotiable debt securities was not a sale because it fell within the "unorthodox transaction" defense to section 16(b) liability announced by the Supreme Court in *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973). The district court denied the Mesa Defendants' motion for summary judgment on October 23, 1989, concluding that genuine issues of material fact existed.

On December 1, 1989, Unocal filed a motion in limine in which it requested the district court to rule, as a matter of law, that the "unorthodox transaction" defense to a section 16(b) violation was inapplicable. In addition, Unocal sought a protective order precluding the Mesa Defendants from introducing any evidence before the jury concerning the "unorthodox transaction" defense. Unocal asserted that if any facts were in dispute concerning the applicability of the "unorthodox transaction" defense, the district court should conduct an evidentiary hearing to resolve the issue before the selection of the jury.

In their opposition to Unocal's motion in limine, the Mesa Defendants "renew[ed] [their] motion for a summary judgment and urge[d] th[e] court to accept plaintiff's belated admission that this is an issue for the Court where the record is sufficiently developed to permit the Court to determine whether the unorthodox transaction exception applies to these facts."

A hearing on the motion in limine was scheduled for January 4, 1990. On that date, the court informed counsel that it would decide the in limine motion concerning the "unorthodox transaction" defense "if there is agreement, unequivocal agreement among counsel that the facts are sufficiently developed to rule on this matter."

Mr. Michael Diamond, counsel for Mesa Petroleum Company, argued that a motion in limine was not the proper vehicle to decide this question. Instead, Mr. Diamond contended that summary judgment is "the way we think it should be decided." After further colloquy, Mr. Diamond stated: "[W]e now renew our summary judgment motion . . . ."

After a brief recess was granted so that Unocal's counsel could consider Mr. Diamond's suggestion, Mr. William Lerach, one of Unocal's attorneys, informed the court as follows: "We are prepared to have the Court treat this issue as tendered to it, if you will, on cross summary judgment motion . . . ."

After further discussion, the court stated: "[Y]our motion in limine will be considered as a cross motion for summary judgment, and Mesa's previously filed summary judgment motion will be reconsidered by the Court, and the record is to be supplemented by a national best seller." The court granted Unocal's unopposed request to receive, as an exhibit, a book written by Mr. T. Boone Pickens. The court declined to hear oral argument concerning the "unorthodox transaction" defense issue.

On January 22, 1990, the court entered an order which "grants Defendants' Motion for Summary Judgment and denies Plaintiffs' Cross-Motion for Summary Judgment."

On January 26, 1990, a hearing was held to determine whether the case should proceed to trial before a jury on January 30, 1990. Unocal argued that a trial was necessary even if the May 20, 1985, exchange of stock for debt securities was an "unorthodox transaction," because the July 3, 1985, disposition of the debt securities by Mesa was a "sale" within section 16(b). The district court reminded Unocal's counsel that during the January 4, 1990, hearing

> you stipulated and agreed that [the in limine] motion may be considered as a cross motion for summary

judgment, and also the representation was made that all of the facts necessary to decide those issues were in the record, either in the motion that was filed by Mesa as Mesa's second motion for summary judgment or in your motion for in limine and elsewhere.

The court informed the parties that they could file supplemental motions relating to the January 19, 1990, order. Counsel for Unocal then inquired as follows:

MR. LERACH: Your Honor, just so I'm clear. You want this done on the existing factual record.

THE COURT: Well, if there are facts that — you see, again, you pose great problems for me. Because the representation was made, it was an unequivocable representation on January the 4th that all of the facts were in the record upon which I could base whatever findings, whatever inferences I could draw for the purpose of ruling on the cross motions for summary judgment. Those facts were before me.

MR. LERACH: That is still our position.

THE COURT: All right.

MR. LERACH: I'm not changing that. I just want to reaffirm that, that we're working off the existing record.

THE COURT: Yes.

MR. LERACH: Thank you.

MR. SNIDER: Neither side will then supplement the record; is that correct, your Honor?

THE COURT: Well —

> MR. SNIDER: The reason I say it's very important, when the submission was made on January 4th, one of the reasons the submission was made to have it treated that way, as a Motion for Summary Judgment. We recessed and we conferred with one another, your Honor will recall, and we came back because we knew what facts were in the record on the issue of voluntariness. And there was a complete void of facts on that record from our point of view with respect to Mesa's position as to either May 20th or July 3rd.

On February 9, 1990, counsel for Mesa Petroleum Company filed a document entitled "Supplemental Motion for Summary Judgment." Mesa Petroleum Company also submitted a proposed order entitled "Supplemental Summary Judgment and Dismissal of Action With Prejudice."

On April 10, 1990, the district court entered a new judgment and vacated the January 19, 1990, order. The court ruled that "[a]lthough Mesa's tender of its Unocal stock in exchange for debt securities can be considered a 'sale', the Court finds that the *Kern County* unorthodox transaction exception applies to the May 1985 exchange offer to exempt it from Section 16(b) liability." The district court again entered an order that granted the Mesa Defendants' motion for summary judgment and denied Unocal's cross motion for summary judgment.

Unocal has timely appealed from the judgment which finally disposes of this section 16(b) action.

DISCUSSION

I. *Nature of the Proceedings Before the Trial Court*

[1] Unocal contends that the district court violated its right to trial by jury by weighing the evidence submitted by the

parties, drawing inferences from conflicting circumstantial evidence, resolving disputed issues of fact, and determining the credibility of T. Boone Pickens' testimony, in ruling on cross motions for a summary judgment. The Mesa Defendants do not dispute Unocal's argument that the district court failed to consider the evidence in the light most favorable to Unocal in ruling on the motion for a summary judgment. Instead, the Mesa Defendants contend that the district court conducted a bench trial, not a hearing on cross motions for summary judgment. The Mesa Defendants argue that we must review the district court's judgment under the clearly erroneous standard.

The record does not support the Mesa Defendants' contention that the parties "authorized the court to conduct a bench trial." Appellees' Brief at 14. The Mesa Defendants requested that the district court reconsider their motion for a summary judgment rather than act on Unocal's motion in limine. The Mesa Defendants prepared a proposed order granting their motion for a summary judgment and dismissing Unocal's action with prejudice.

The Mesa Defendants' reliance on *Wolfe v. United States*, 798 F.2d 1241 (9th Cir.), *amended on other grounds*, 806 F.2d 1410 (9th Cir. 1986), *cert. denied*, 482 U.S. 927 (1987), is misplaced. In *Wolfe*, we concluded, after reviewing the record, that "the parties intended to submit the case for a bench trial on stipulated facts." *Id.* at 1243-44 n.2. The other cases relied upon by the Mesa Defendants also involve facts showing that the parties intended to waive trial by jury and try their cases on stipulated or agreed facts. *Starsky v. Williams*, 512 F.2d 109, 111 (9th Cir. 1975); *Southwest Forest Indus., Inc. v. Westinghouse Elec. Corp.*, 422 F.2d 1013, 1016-17 (9th Cir.), *cert. denied*, 400 U.S. 902 (1970); *Gillespie v. Norris*, 231 F.2d 881, 883 (9th Cir. 1956).

Unlike the situation in the cases relied upon by the Mesa Defendants, in the instant matter the parties expressly agreed to have the court decide the applicability of the "unorthodox

transaction" defense on cross motions for summary judgment. The court reflected this mutual understanding by stating: "It's now stipulated to be a motion, a cross summary judgment motion."

On the same date that the "unorthodox transaction" defense issue was submitted to the court for decision without oral argument on the cross motions for summary judgment, the record reflects that the court inquired of counsel about the "timing for trial." The court stated that "[t]here is a distinct possibility that I can start this case on January 30th." After some discussion, the trial date was set for January 30, 1985. Mr. Diamond, an attorney for Mesa Petroleum Company, then inquired of the court how counsel should respond "on the question of our desires on the jury/non-jury issue?" The court replied: "Make up your mind and let me know." Another of Mesa Petroleum Company's attorneys, Mr. James Edward Maloney, whose law office is in Texas, then asked the court whether the trial judge conducts the voir dire in the Central District of California. Thereafter, Mr. Maloney's request to be allowed to question the prospective jurors on voir dire was granted.

In light of the state of the record in this matter, which shows that the Mesa Defendants requested that the court determine the applicability of the "unorthodox transaction" defense on summary judgment rather than in a non-reviewable motion in limine proceeding, and sought permission to participate in the voir dire examination of the jurors, if they decided not to waive a trial by jury, we are troubled that they now argue that the record shows that the parties agreed to a bench trial. This type of overzealous advocacy burdens the court with a frivolous argument and does little to guide us in our efforts to reach a just result.

[2] Because the record demonstrates that the district court decided the applicability of the "unorthodox transaction" defense in response to the Mesa Defendants request that the

denial of its motion for a summary judgment be reconsidered, we must reject their contention that we should review the judgment for clear error.

[3] We review an order granting summary judgment *de novo*. *Ashton v. Cory*, 780 F.2d 816, 818 (9th Cir. 1986). Thus, we are required to review all the evidence presented to the district court in the light most favorable to the non-moving party. *Id.* We must also make an independent, non-deferential, determination concerning the question whether the district court correctly applied the law. *Id.* Because our review is independent, any error committed by the district court in weighing the evidence, drawing inferences from disputed facts, and in determining credibility in this matter was harmless.

II. *Applicability of the "Unorthodox Transaction" Defense Under These Facts*

Unocal argues that the district court erred in concluding that the "unorthodox transaction" defense to an action for disgorgement of short-swing profits by a beneficial owner is applicable if the facts in the record in this matter are viewed in the light most favorable to the Mesa Defendants. Unocal asks this court to direct the entry of a summary judgment in its favor on the ground that the exchange of the Mesa Defendants' common stock for negotiable debt securities was a "sale" within section 16(b). Unocal asserts that the "unorthodox transaction" defense to an action brought pursuant to section 16(b) is not applicable to a self-tender offer in which a beneficial owner exchanges his common stock for negotiable debt securities issued as a result of a recapitalization of the issuer.

[4] Section 16(b) of the Securities Exchange Act of 1934 provides that an issuer may recover any profits realized by a beneficial owner from the sale of the issuer's equity securities

within a six-month period.[5] A beneficial owner is a shareholder who owns, directly or indirectly, more than ten percent of any class of equity security. 15 U.S.C. § 78p(a) (1988).

One goal of the Securities and Exchange Act of 1934 is to " 'insure the maintenance of fair and honest markets.' " *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 591 (1973) (quoting 15 U.S.C. § 78b). In adopting section 16(b), Congress intended "to curb manipulative and unethical practices resulting from misuse of corporate information for personal enrichment or unfair profit of the insider, thereby assuring the strict observance of the insider's fiduciary duties to outside shareholders and the corporation by removing the profit from short-swing dealing in corporate securities." *Oliff v. Exchange Int'l Corp.*, 669 F.2d 1162, 1165 (7th Cir. 1980), *cert. denied*, 450 U.S. 915 (1981).

In order to achieve these goals, Congress adopted "a flat rule taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great." *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 422 (1972). " 'The objective standard of Section 16(b) imposes strict liability upon substantially all transactions occurring within the statutory time period, regardless of the intent of the insider or the existence of actual speculation.' " *Id.* (quoting *Bershad v. McDonough*, 428 F.2d 693, 696 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971)).

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[5]Section 16(b) provides in pertinent part:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction . . . .

15 U.S.C. § 78p(b) (1988).

Section 16(b) has been referred to as a "crude rule of thumb." *Kern County Land Co.*, 411 U.S. 582, 592-93 n.23 (1973) (quoting *Hearings on Stock Exchange Practices before the Senate Committee on Banking and Currency*, 73d Cong., 2d Sess., pt. 15, at 6557 (1934)). We have described the application of section 16(b)'s bright-line rule as "mechanical," *Portnoy v. Memorex Corp.*, 667 F.2d 1281, 1282 (9th Cir. 1982), and "automatic," *Whittaker v. Whittaker Corp.*, 639 F.2d 516, 522 (9th Cir.), *cert. denied*, 454 U.S. 1031 (1981). Where a transaction involving an equity security falls within the objective standards established by Congress for section 16(b), liability attaches. *Id.*

[5] The Securities Exchange Act of 1934 broadly defines "sale" as "any contract to sell or otherwise dispose of" any security. 15 U.S.C. § 78c(a)(14) (1988). A "sale" has been deemed to occur "when an insider becomes irrevocably *entitled* to receive a sum certain for his security," *Seinfeld v. Hospital Corp. of Am.*, 685 F. Supp. 1057, 1062 n.5 (N.D. Ill. 1988) (emphasis in original), or when "the insider has incurred an 'irrevocable liability' to dispose of the stock so that his 'rights and obligations' have become fixed," *Lewis v. Bradley*, 599 F. Supp. 327, 330 (S.D.N.Y. 1984).

The district court concluded that "[a]lthough Mesa's tender of its Unocal stock in exchange for debt securities can be considered a 'sale', the Court finds that the *Kern County* unorthodox transaction exception applies to the May 1985 exchange offer to exempt it from Section 16(b) liability."

The Mesa Defendants conceded, at oral argument, that their exchange of Unocal equity stock for debt securities pursuant to Unocal's self-tender offer was a "sale" if section 16(b) is given a literal interpretation.[6] The Mesa Defendants contend

[6]During oral argument, the court questioned whether the exchange transaction would fit within the broad definition of "sale," as that term is used in section 16(b). Counsel for the Mesa Defendants responded: "Yes, your honor, were it not for the [unorthodox transaction] exemption, it would."

that their exchange of stock for non-convertible debt securities on May 20, 1985, falls within the "unorthodox transaction" defense to section 16(b) liability established by the Supreme Court in *Kern County*.

In *Kern County*, the Supreme Court addressed the following fact-specific question: "[I]s it a § 16(b) 'sale' when the target of [a] tender offer defends itself by merging into a third company and the tender offeror then exchanges his stock for the stock of the surviving company and also grants an option to purchase the latter stock that is not exercisable within the statutory six-month period?" 411 U.S. at 584.

In *Kern County*, Occidental Petroleum Corporation announced a tender offer to purchase 500,000 shares of Kern County Land Company (Kern County) common stock. The tender offer was expressly due to expire on June 8, 1967. *Id.* Kern County opposed Occidental's takeover attempt and, on May 19, 1967, announced the Board of Directors' approval of a "defensive" merger with Tenneco, Inc. *Id.* at 585-86. Pursuant to the merger, the Kern County shareholders would receive one share of Tenneco cumulative convertible preference stock for each share of Kern County common stock. *Id.*

The Kern County shareholders approved the merger with Tenneco on July 17, 1967. *Id.* at 588. Occidental issued a statement that it had decided not to oppose the merger, but it refrained from voting its shares in favor of the merger. *Id.* The merger between Kern County and Tenneco became effective on August 30, 1967, within six months from the expiration date of the Occidental tender offer. *Id.* at 589. On this date, all Kern County shareholders became irrevocably entitled to receive one share of Tenneco preference stock in exchange for each share of Kern County stock. *Id.* Occidental realized a $19,506,419.22 profit on the Kern County shares it acquired through its tender offer. *Id.* at 589-90.

The new Kern County Land Company that was formed as a result of the merger, filed an action against Occidental under

section 16(b) to recover the profits from the sale. *Id.* at 590. The district court held that the automatic exchange of shares on August 30, 1967, constituted a "sale" within the meaning of section 16(b). *Id.* The Second Circuit reversed, holding that the automatic exchange of shares pursuant to the merger did not constitute a "sale" for section 16(b) purposes. *Id.* at 590-91. The Supreme Court granted certiorari. *Id.* at 591.

In determining whether the exchange of stock pursuant to the merger between Kern County and Tenneco was a "sale" giving rise to section 16(b) liability, the Supreme Court first recognized that the statute imposed a " 'flat rule.' " *Id.* at 592 (quoting *Reliance Elec. Co.*, 404 U.S. at 422). The Court then noted that

> [a]lthough traditional cash-for-stock transactions that result in a purchase and sale or a sale and purchase within the six-month, statutory period are clearly within the purview of § 16(b), the courts have wrestled with the question of inclusion or exclusion of certain "unorthodox" transactions. . . . In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent — the realization of short-swing profits based upon access to inside information — thereby endeavoring to implement congressional objectives without extending the reach of the statute beyond its intended limits.

Id. at 593-95 (footnotes omitted).[7]

[7]Courts have referred to *Kern County*'s approach to determining section 16(b) liability in unorthodox transactions as a "pragmatic" approach, *Provident Sec. Co. v. Foremost-McKesson, Inc.*, 506 F.2d 601, 604 (9th Cir. 1974), *aff'd on other grounds*, 423 U.S. 232 (1976), in contrast to the "objective" approach of imposing liability in transactions which are clearly within the ambit of section 16(b).

[6] The Court held that the exchange of Kern County stock for Tenneco stock on August 30, 1967, was not a "sale" within the scope of section 16(b). *Id.* at 596. The Court concluded that "the involuntary nature of Occidental's exchange, when coupled with the absence of the possibility of speculative abuse of inside information, convinces us that § 16(b) should not apply to transactions such as this one." *Id.* at 600. In reaching this conclusion, the Court characterized as "critical" the fact that the exchange was required pursuant to the merger between Kern County and Tenneco. *Id.* at 599. "Once the merger and exchange were approved, Occidental was left with no real choice with respect to the future of its shares of Old Kern." *Id.* at 600.

[7] The exchange of Unocal stock for debt securities pursuant to Unocal's tender offer is factually distinguishable from the transaction in *Kern County*. The exchange of Occidental's stock for equity shares of the new corporation which was formed as the result of the merger in *Kern County* was involuntary and automatic. The May 20, 1985, exchange of stock for debt securities by the Mesa Defendants was not an involuntary or automatic transaction. Unocal did not merge into a new corporation so as to compel its shareholders to exchange their stock.

The Mesa Defendants not only were not compelled to exchange their stock for Unocal's debt securities, but Unocal expressly excluded them from its self-tender offer. The Mesa Defendants filed a suit in Delaware seeking an injunction to force Unocal to permit the Mesa Defendants to participate in Unocal's tender offer.

[8] The Mesa Defendants had the choice of participating in the tender offer or holding onto their stock. The record shows that it was anticipated that Unocal's stock would sell at $30 a share as a result of the exchange set forth in the tender offer. One of the choices available to the Mesa Defendants was to

buy up Unocal's stock at the reduced price of $30 a share and acquire control of the corporation.

[9] The evidence is undisputed that the Mesa Defendants initiated negotiations with Unocal, seeking participation in the self-tender offer. In the book, *Boone*, which is part of the record in this matter, T. Boone Pickens states that one of his attorneys told Unocal representatives that "[Mesa] would have to be included in their tender offer or take action to protect [them]selves." T. Pickens, *Boone* 282 (1987). The parties dealt at arms length in the negotiations that followed. Unocal was concerned that if the Mesa Defendants were excluded, they might buy up the devalued shares at a bargain price and seize control of the corporation. Mr. Pickens describes the stakes for each side in the negotiations following the Delaware Supreme Court's decision in favor of Unocal as follows:

> This meant that Hartley didn't have to offer Mesa anything. He could buy back the stock from all the shareholders but us, decreasing the value of the remaining Unocal stock. If Unocal bought back 70 million shares at $72, that left 100 million shares that would be worth a lot less, including all of the Mesa Partners holdings, which would drop to around $30 a share after the buyback. Our stock would then be worth less than $700 million — a loss of about $300 million.
>
> This new ruling was unprecedented, but there was no use crying about it. We had a choice: we could make a deal with Unocal, or after they concluded their tender offer we could make a 100 percent all-cash offer for the company. We got a call from Drexel asking us not to fold. They had raised $3 billion and were ready to raise the additional funds for us to make a 100 percent offer. It was an unqualified endorsement of Mesa, and it naturally gave us a lift.

> It would be a great campaign, no doubt about it, but the risks were getting very high. It wasn't time to get emotionally involved. It hadn't been a year since we had gotten out of a $300 million jam, so I wasn't ready to step up to the table and put everything on 7 and call for the dice. It might work — but it might not. If Mesa went all out for Unocal, Hartley would probably pull the same exclusionary self-tender the second time, and then we would be back in the Delaware court. We had been nailed once, and that was one time too many.
>
> We could force Fred to take on even more debt, and he was gagging now. But there was no guarantee we would win.

Id. at 281.

In a subsequent passage, Mr. Pickens stated:

> Stillwell got a call from Los Angeles on Sunday afternoon. Hartley was ready to talk. He would agree to Mesa's demands but had one of his own. He wanted us to pay Unocal's expenses — a silly request but a big point to Hartley. If he could get us to pay his expenses, he would never let us forget it. We still had our tax treatment "ace" up our sleeve. If we were included in Unocal's offer and held the remainder of our stock for a year, we would make around $80 million after taxes. The trick was to keep Unocal from figuring it out.

Id. at 282.

Mr. Pickens describes the effect of the negotiations on Unocal and the Mesa Defendants as follows:

> Our team signed the deal and flew home on Monday night. The Mesa-Unocal deal was history. Hartley

> was soon crowing that he had defeated Pickens and tied up Mesa for a year because we had to hold their stock. He claimed we had lost $100 million. It was just the opposite. We were going to make money, but we couldn't announce it until our auditors, Arthur Anderson, had signed off. We also wanted to receive the proceeds from Unocal before announcing any profit. That meant waiting sixty days or so, but we just didn't trust them.
>
> I could barely keep quiet as I read Hartley's claims of having 'beaten' Mesa. Then, two months later, the Unocal bonds in hand, we enjoyed the last laugh — $83 million profit after taxes, twice what we had made in the Phillips deal.
>
> When you have to explain a victory, it becomes something less. Gradually the financial community, the press, and the academicians came to understand what we had done.

Id. at 284.

[10] Unlike the plight of the hapless beneficial owner in *Kern County*, the record conclusively shows that the Mesa Defendants voluntarily exchanged their common stock for negotiable debt securities. The exchange in the matter *sub judice* was not the inexorable consequence of corporate machinations that forced the stockholders to exchange their shares as the result of the dissolution of the corporation. Here, the beneficial owners controlled their own destiny and skillfully negotiated a result that Mr. Pickens characterized as a victory for his side.

Courts following *Kern County* have recognized that involuntariness is an important factor in determining whether or not a transaction constitutes a "sale" or "purchase" within section 16(b). In *Provident Sec. Co. v. Foremost-McKesson, Inc.*,

506 F.2d 601 (9th Cir. 1974), *aff'd on other grounds*, 423 U.S. 232 (1976), we stated that "[a]bsent a showing of involuntariness, we would not be justified in applying the *Kern County* rule." *Id.* at 606. *See also Texas Int'l Airlines v. National Airlines, Inc.*, 714 F.2d 533, 540 (5th Cir. 1983) ("[T]he volitional character of the exchange is sufficient reason to trigger applicability of the language of section 16(b)."), *cert. denied*, 465 U.S. 1052 (1984); *Gund v. First Florida Banks, Inc.*, 726 F.2d 682, 686 (11th Cir. 1984) ("The vast majority of cases in which the pragmatic approach has been followed involve involuntary transactions which are triggered by a corporate reorganization . . . .").

[11] The Mesa Defendants argue that "otherwise volitional transactions" are unorthodox under section 16(b) if a beneficial owner is coerced economically into exchanging his common stock or suffer a financial loss. In *Oliff v. Exchange Int'l Corp.*, 669 F.2d 1162 (7th Cir. 1980), *cert. denied*, 450 U.S. 915 (1981), the Seventh Circuit found that although a 205% tax payment was not a "reasonable alternative" to the repurchase of shares which gave rise to section 16(b) liability, the acquisition of the stock was not "so involuntary as to take it out of the definition of 'purchase' for 16(b) purposes." *Id.* at 1168. In *Tyco Laboratories, Inc. v. Cutler-Hammer, Inc.*, 490 F. Supp. 1 (S.D.N.Y. 1980), the court rejected the argument that section 16(b) should not apply because the sale of stock was coerced. The court stated that

> [a]lthough plaintiffs had the option to maintain their ownership interest in C-H stock, they chose not to exercise that option. The fact that plaintiffs may have found it to be more financially advantageous to sell their C-H stock on June 12, 1978 than at a later time cannot be a basis for characterizing the sale transaction as involuntary.

Id. at 8.

[12] An economic coercion test would allow corporate insiders to avoid section 16(b) liability by presenting evidence of a variety of unfortunate circumstances that forced them to sell their common stock. The objective standards of section 16(b) were adopted to avoid the necessity for an inquiry into an insider's subjective "intent." *Reliance Elec. Co.*, 404 U.S. at 422 (quoting *Bershad*, 428 F.2d at 696). We reject the "economic coercion" test as contrary to the intent of Congress in enacting the bright-line, flat rule set forth in section 16(b) requiring disgorgement of profits.

[13] We conclude that the facts in this matter do not come within the holding of *Kern County* that an involuntary transaction that results from a merger is "unorthodox."

The cases that have applied the *Kern County* "unorthodox transaction" defense to a short-swing sale by a beneficial owner have characterized it as a narrow exception to section 16(b). *See, e.g., Texas Int'l Airlines*, 714 F.2d at 539 ("In *Kern County* the Supreme Court approved an extremely narrow exception to the objective standard of section 16(b)."). The Supreme Court did not indicate that the courts should conduct an ad hoc, case-by-case analysis of all securities transactions involving a sale by a beneficial owner. The Court in *Kern County* simply held that an automatic exchange of stock in one company for stock in another company pursuant to a merger between the two companies, over which the shareholder had no control, is not a form of transaction covered by section 16(b). 411 U.S. at 600.

The majority of the transactions which have been considered "unorthodox" within the narrow exception announced in *Kern County* involve exchanges of stock pursuant to a merger. *See, e.g., Heublein, Inc. v. General Cinema Corp.*, 722 F.2d 29, 31 (2d Cir. 1983) (section 16(b) is not intended to apply to an involuntary exchange of shares resulting from a merger), *cert. denied*, 465 U.S. 1066 (1984); *American Standard, Inc. v. Crane Co.*, 510 F.2d 1043, 1053 (2d Cir. 1974) (*Kern*

County applies to a defensive merger where the beneficial owner tries to defeat it), *cert. denied*, 421 U.S. 1000 (1975); *Gold v. Sloan*, 486 F.2d 340, 344 (4th Cir. 1973) (exchange of shares pursuant to a merger may not constitute a purchase under section 16(b)), *cert. denied*, 419 U.S. 873 (1974); *National Westminster Bancorp v. Leone*, 702 F. Supp. 1132, 1138 (D.N.J. 1988) (merger is an "unorthodox transaction" requiring an examination of the goals of section 16(b)); *Colan v. Prudential-Bache Secs., Inc.*, 577 F. Supp. 1074, 1081 (N.D. Ill. 1983) ("forced exchange of securities pursuant to a merger" is not a sale within section 16(b)).

Those courts that have directly addressed the issue of section 16(b) liability in a tender offer or hostile takeover context have concluded that the disposition of shares pursuant to a tender offer, or in the face of defeat in a takeover contest, is not an "unorthodox transaction" under *Kern County*. In *Super Stores, Inc. v. Reiner*, 737 F.2d 962 (11th Cir. 1984), the Eleventh Circuit held that *Kern County* did not create an exception from the short-swing profit prohibitions of section 16(b) for a transaction in which "a corporate officer and director facing defeat in a tender offer battle voluntarily tendered his stock to his opponents for cash." *Id.* at 965. In *T-Bar, Inc. v. Chatterjee*, 693 F. Supp. 1 (S.D.N.Y. 1988), a defeated tender offeror converted debentures into common stock of the target corporation and tendered those shares into a competing cash tender offer for 70% of the target's stock. *Id.* at 4. The court held that this transaction was not the form of transaction held to be "unorthodox" in *Kern County*. *Id.* at 5. Instead, the court stated that "[u]nlike the defendant in *Kern County*, Beall made a business decision to tender its shares into the Data Switch offer." *Id.*

In a hostile takeover situation, the Fifth Circuit held that *Kern County* did not apply to a transaction in which a defeated tender offeror sold its shares in the target corporation to a company with which the target had entered into a merger agreement. *Texas Int'l Airlines*, 714 F.2d at 540. In *Tyco Lab-*

oratories, the court rejected a claim that the existence of a "control contest type of situation" renders the sale of stock to a third party "unorthodox" within the meaning of *Kern County*. 490 F. Supp. at 6. In *Lane Bryant, Inc. v. Hatleigh Corp.*, 517 F. Supp. 1196 (S.D.N.Y. 1981), a ten-percent shareholder facing opposition to its intended proxy contest sold all of its stock to the corporation for a premium. *Id.* at 1197-98. The court found that *Kern County*'s pragmatic test for "unorthodox transactions" was inapplicable, ruling instead that

> the objective test [of § 16(b)] should clearly apply to the instant case since the defendant here both purchased and sold plaintiff's stock for cash and, while there was a contest for control, this case differs from Kern County and American Standard, where the target merged with a third corporation, causing the defendant tender offeror to become a minority shareholder in the third corporation, in that here there was no defensive merger, but rather the defendant simply decided it was unprofitable to pursue the proxy contest.

Id. at 1200.

Mesa cites only one case, *Pier 1 Imports of Georgia, Inc. v. Wilson*, 529 F. Supp. 239 (N.D. Tex. 1981), in which a tender offer was determined to be an "unorthodox transaction" for section 16(b) purposes. In *Pier 1 Imports*, the court stated that "a tender offer has been found to fall within the unorthodox transaction rubric rather than a 'garden variety' Section 16(b) claim." *Id.* at 242-43. The district court in *Pier 1 Imports* cited *Makofsky v. Ultra Dynamics Corp.*, 383 F. Supp. 631, 637 (S.D.N.Y. 1974), and *Securities and Exchange Commission v. Texas Int'l Co.*, 498 F. Supp. 1231, 1239 (N.D. Ill. 1980), for this proposition. *Pier 1 Imports*, 529 F. Supp. at 242-43. *Makofsky* and *Texas Int'l* do not support the district court's holding in *Pier 1 Imports*.

Makofsky does not involve a tender offer. It involves a section 16(b) action seeking recovery of profits realized by an insider through the purchases and sales of option shares. *Makofsky*, 383 F. Supp. at 636. The court held that section 16(b) was applicable. *Id.* at 643. The language in *Makofsky*, upon which *Pier 1 Imports* relies, stating that "tender offers . . . are not suited to mechanical application of the statute," is dictum and is based on pre-*Kern County* cases, none of which involve an exchange of stock pursuant to a tender offer. *Id.* at 637.

In *Texas Int'l*, the district court had before it a claim filed by the SEC pursuant to section 14(b) of the Williams Act. The applicability of section 16(b) was not an issue in *Texas Int'l*. Section 16(b) was referred to in a parenthetical explanation of *Kern County*'s application of the "unorthodox transaction" in deciding whether to apply section 16(b). 498 F. Supp. at 1239.

[14] We agree with the Eleventh Circuit in *Super Stores*, and the district court in *T-Bar Inc.*, that the sale or purchase of stock pursuant to a tender offer is not an "unorthodox transaction."

[15] The Mesa Defendants assert that the exchange of their common stock for debt securities was an "unorthodox transaction" because it resulted from a recapitalization of Unocal. The Mesa Defendants rely primarily on the Supreme Court's comment in footnote 24 in *Kern County* to support this proposition. 411 U.S. at 593 n.24. In footnote 24, the Court observed that "[t]he term [unorthodox transaction] . . . has been applied to stock conversions, exchanges pursuant to mergers and other corporate reorganizations, stock reclassifications, and dealings in options, rights, and warrants." *Id.* The Mesa Defendants reason that since a recapitalization is a form of corporate reorganization, it must constitute an "unorthodox transaction."

[16] The comment in footnote 24 in *Kern County* was not necessary to the opinion in *Kern County*. *Kern County* did not

involve recapitalization. The Court, without expressing its approval, enumerated the types of business transactions that others have labeled as "unorthodox." The Court did not cite any authority to support its observation in footnote 24. Thus, we cannot determine whether the Court was referring to decisions construing section 16(b).

The Mesa Defendants rely on two district court decisions published solely in the Federal Securities Law Reporter to support their view that a corporate recapitalization is an "unorthodox transaction." Neither supports their position. In *Rothenberg v. United Brands Co.*, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,045 (S.D.N.Y. May 11, 1977), *aff'd without opinion*, 573 F.2d 1295 (2d Cir. 1977), the district court concluded that no violation of section 16(b) occurred because the record showed that "[w]hen United exchanged or converted these common shares into Class A, the total amount of its investment in Foster did not change." *Id.* at 91,694. The court concluded that this exchange did not involve a new investment. *Id.* The court held that "[i]t would appear that to be a sale under § 16(b), there must be some change in either the character of the investment or the nature of the market risk assumed." *Id.*

[17] In *Hayes v. Sampson*, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,693 (S.D.N.Y. Nov. 18, 1980), the district court, relying on *Rothenberg*, held that no sale within section 16(b) occurred where the directors of a corporation exchanged old debentures for new debentures because "neither the amount invested nor the percentage of ownership of this class of security changed within the six month period relevant under Section 16(b)." *Id.* at 98,644. If anything, *Rothenberg* and *Hayes* stand for the proposition that a recapitalization which results in a change in the nature of a beneficial owner's investment and market risk is a sale within section 16(b).

In the instant matter, the nature of the Mesa Defendants' investment was changed. They exchanged common stock for

negotiable debt securities with a higher market value. The Mesa Defendants' market risk also changed from that of an equity owner of shares in a corporation, subject to market fluctuations, to a holder of negotiable debt securities which obligated Unocal to pay a fixed sum at a certain maturity date together with periodic interest payments.

CONCLUSION

The evidence is undisputed that the Mesa Defendants made a voluntary business decision to persuade Unocal to permit them to participate in the corporation's self-tender offer. As a result, the Mesa Defendants exchanged common stock, whose value was subject to the risks of a free market, for negotiable debt securities of a higher current value with fixed payments and interest rates. The record also shows that the Mesa Defendants shrewdly calculated their options, which included a complete buy out of all of Unocal's stock or acceptance of the self-tender offer because of undisclosed tax advantages. We conclude that the exchange of the Mesa Defendants stock for Unocal's negotiable debt securities was a sale within section 16(b). Because of our determination that this exchange was not an "unorthodox transaction," we do not review the record to determine whether the Mesa Defendants had the opportunity to engage in the speculative abuse of inside information.

The order granting summary judgment in favor of the Mesa Defendants is **REVERSED**. The order denying Unocal's cross motion for a summary judgment is **REVERSED** with directions to enter an order granting Unocal's motion for a summary judgment.

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Appendix B

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

DAVID COLAN AND UNOCAL CORPORATION, *Plaintiffs,* v. MESA PETROLEUM CO., *et. al.* *Defendants.*	CASE NO. CV 86-3564 JGD ORDER RE: CROSS MOTIONS FOR SUMMARY JUDGMENT

This securities case arising under Section 16(b) of the Securities and Exchange Act of 1934 is presently before the Court on the parties' Cross-Motions for Summary Judgment. The question presented to the Court is whether on the facts of this case a sale exists for the purpose of Section 16(b) liability.

STATEMENT OF THE CASE

Unocal is a corporation organized and existing under the laws of the state of Delaware with its principal place of business in Los Angeles, California. Unocal engages in exploration and production activities in the major oil and gas areas of the United States and 14 foreign countries. Mesa Petroleum Co. was a corporation organized under the laws of the state of Delaware with its principal place of business in Amarillo, Texas. Until December 27, 1985, Mesa Petroleum was engaged in the exploration for and production of natural gas. Mesa Partners II was a Texas general partnership which was dissolved on May 20, 1985. The remaining defendants are either wholly owned subsidiaries of Mesa Petroleum or general partners in Mesa Partners II.[1] Prior

[1] Defendants, hereinafter "Mesa", are Mesa Petroleum Co., Mesa Southern Co., Mesa Asset Co., Cy-41, Inc. and Jack-41, Inc. Mesa

to this litigation, Mesa had invested in, owned, and traded various securities.

In October 1984, Mesa began to invest in Unocal stock. From October into early February 1985, Mesa purchased Unocal shares through the Fayez Sarofim Trust Company. In February 1985, Mesa began to purchase Unocal stock through Jefferies & Co., a Los Angeles stock brokerage firm. Mesa first publicly announced its Unocal holdings on February 14, 1985; on that date, Mesa filed a Schedule 13D with the Securities and Exchange Commission ("SEC") indicating that Mesa had acquired 7.3 percent of Unocal's outstanding stock as an investment.[2] As of February 22, 1985, Mesa owned 17 million shares which equalled 9.7 percent of the outstanding shares of Unocal stock.

By March 27, 1985, Mesa had purchased 6.7 million additional shares of Unocal stock at a price of $48.10 per share.[3] Mesa now owned 23.7 million Unocal shares and was a more than 10% owner of Unocal stock. On March 28, 1985, Mesa announced its intention to wage a proxy fight to postpone the annual Unocal shareholders' meeting. At the same time, Mesa filed a third amendment to its Schedule 13D which stated that Mesa might seek control of Unocal. On April 1, 1985, Unocal sued Mesa in the United States District Court for the Central District of

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Partners II originally named as a defendant in this action was dissolved on May 20, 1985.

[2] Any person who either directly or indirectly becomes a beneficial owner of more than five percent of stock shall, within ten days of such acquisition, send to the issuer of the stock, the exchanges upon which the security is traded, and the Commission certain statutorily required information. 15 U.S.C. 78m(d).

[3] Although the parties continue to dispute the manner in which this stock was obtained and whether the stock price was actually $48.10 or $48 with a 10 cents per share commission to Jefferies & Co. as broker, the issue of a Section 16(b) purchase is not relevant to these motions. The unorthodox transaction exception concerns the applicability of a "sale" for the purpose of Section 16(b) liability.

California challenging the accuracy of statements in Mesa's original Schedule 13D. Mesa counterclaimed urging violations of the proxy solicitation rules.

On April 8, 1985, Mesa commenced a tender offer to purchase 64 million shares of Unocal stock at $54 per share. The market price of Unocal stock at the time was $49 per share. Unocal's Board of Directors publicly rejected Mesa's tender offer on April 14, 1985. On April 16, Unocal responded to Mesa's tender offer by proposing its own self tender offer which Unocal made contingent upon Mesa's success. In essence, Unocal offered to exchange debt securities in the principal amount of $72 per share for up to 87.2 million shares, approximately one-half of the 173.9 million shares of Unocal stock outstanding. Unocal modified this offer on April 23 to reflect its willingness to purchase up to 50 million shares of its common stock regardless of whether Mesa actually purchased the 64 million shares it was seeking. It was generally anticipated that any shares not acquired by Unocal in the exchange would have a market value thereafter equalling $30 per share.[4]

The novel aspect of Unocal's exchange offer was that it specifically excluded Mesa from tendering its Unocal stock. Assuming *arguendo* that Mesa made no other attempt to alter its Unocal holdings, such exclusion, upon completion of the exchange, would result in a decrease in the value of Mesa's Unocal holdings from $1,160 million (23.7 million shares at $49 per share) to $711 million (23.7 million shares at $30 per share).

Mesa filed lawsuits in both federal court and Delaware state court challenging Unocal's exchange offer and its discriminatory provision. On April 22, 1985, the United States District Court for the Central District of California postponed Unocal's annual

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[4] To cushion the drop in the price of the Unocal stock expected from the $3.6 billion increase in Unocal's debt that would result from the exchange, Unocal also announced its intention to form a master limited partnership affecting certain assets of its principal operating subsidiary, Union Oil Company of California.

meeting for two weeks; the court further found that Unocal's exclusion of Mesa from its offer did not violate federal law and was in fact a state law matter. Although the Delaware Chancery Court temporarily enjoined the offending provision, the Delaware Supreme Court on May 17, 1985 reversed the Chancery Court and upheld the exclusion of Mesa from Unocal's exchange offer.

In late April, Unocal announced that midnight, EST, May 17, 1985, would constitute the proration and withdrawal date for its exchange offer. However, wanting to end Mesa's tender offer as well as the threat of a future offer, Unocal and Mesa representatives met to discuss settlement options on May 14. Due to restrictions imposed by federal law on purchases during a tender offer or exchange offer,[5] the only mechanism available to Unocal to make a payment to Mesa and at the same time reduce Mesa's ownership interest in Unocal was the inclusion of Mesa in Unocal's exchange offer.

On May 15, Unocal proposed to include Mesa in the exchange offer and to devise a standstill agreement whereby Mesa's future role with regard to Unocal would be significantly limited. Mesa rejected Unocal's proposal. On May 17, after the Delaware Supreme Court rendered its decision against Mesa, Mesa sought to reopen discussions with Unocal. On May 20, 1985, the parties reached a settlement agreement which encompassed the following principal provisions:

(1) Mesa agreed to terminate its tender offer and to adhere to the following standstill provisions:

a) Mesa agreed for a period of twenty five years not to participate in any proxy solicitation and not to acquire any additional Unocal shares;

b) Mesa agreed for a period of ten years to vote its Unocal stock on all matters in the same way and in the same proportion as those held by non-Mesa shareholders;

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[5] *See* 17 CFR 240.10b-13.

c) Mesa agreed to strict controls upon the sale of its Unocal stock.

(2) In return, Mesa would be allowed to tender its Unocal stock into the exchange offer.

The exchange provided for shareholder participation to an extent proportional to the shareholder's Unocal holdings. In exchange for its Unocal stock, a shareholder received debt securities valued at $75 per share of Unocal stock. On May 20, 1985, Mesa exchanged 7,846,705 shares of Unocal stock for nonconvertible debt securities. In light of the participation of other shareholders on a proportional basis, Mesa's ownership interest in Unocal after the exchange remained the same, 13.6%. On July 3, 1985, Mesa cashed out its debentures for approximately $589 million.

By letter dated November 25, 1985, a Unocal shareholder, David Colan, communicated through his lawyer to Unocal a belief that a possible violation of Section 16(b) may have resulted from Mesa's acquisition and subsequent sale of its Unocal stock. On December 17, 1985, Dennis Codon, Assistant to the General Counsel at Unocal, wrote to Mr. Colan that after an internal review and consultation with outside counsel, Unocal had concluded that Mesa had not violated Section 16(b).[6]

On June 3, 1986, David Colan filed a derivative action on behalf of Unocal Corporation alleging violations of Section 16(b) of the Securities and Exchange Act by Mesa. 15 U.S.C. 78p(b). Unocal was named as a defendant. As late as June 26, 1989, Unocal in its First Amended Answer denied that Unocal had given Mesa access to any inside information. However, in this

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[6] Specifically, Unocal stated that the one time block purchase which caused Mesa to exceed ten percent ownership was not considered a "purchase" for purposes of the "purchase" requirement under Section 16(b); therefore, Mesa's sale of Unocal stock did not create the necessary "purchase" and "sale" for imposition of Section 16(b) liability.

same document, Unocal stated that on the basis of discovery and information from the U.S. Attorney about investigations into insider trading which indicated that the principal transaction in question was not a single block trade, Unocal believed that disgorgement of profits pursuant to Section 16(b) was proper. On August 23, 1989, Unocal was realigned as a party-plaintiff.

Mesa initially raised the unorthodox transaction exception to Section 16(b) created by the Supreme Court in *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 93 S.Ct. 1736, 36 L.Ed.2d 503 (1973) as an affirmative defense in its Answer filed on July 14, 1986. Subsequently, Mesa filed its Second Motion for Summary Judgment in which it asserted that none of the three key Section 16(b) elements was present in this case. In denying Mesa's motion on October 23, 1989, the Court found that genuine issues of material fact remained in dispute concerning, *inter alia,* the existence of a Section 16(b) sale. On November 3, 1989, the Court denied Mesa's Ex Parte Application to Certify this question for Interlocutory Appeal.

On December 1, 1989, Plaintiffs filed a motion seeking an order *in limine* that the unorthodox transaction exception did not apply in this case. In conjunction with other *in limine* motions, this question came before the Court for hearing on January 4, 1990. At the hearing, Mesa renewed its request that the Court reconsider its Second Motion for Summary Judgment as it relates to the unorthodox transaction exception. At the same time, Plaintiffs requested that the Court consider their *in limine* motion as a cross-summary judgment motion on this issue. All parties agreed that the facts were fully developed in the present record so that the Court could decide this issue as a question of law. On the basis of this representation, the Court took the two motions for summary judgment under submission on January 4, 1990.

The Court considered the two motions as cross motions for summary judgment. The Court reviewed and considered all papers which were filed in conjunction with Plaintiffs' *in limine* motion and again reviewed and considered Mesa's Second Summary Judgment Motion, as well as all pleadings and all other

papers filed in this action. On January 19, 1990, the Court issued an Order granting Defendant's Motion for Summary Judgment and denying Plaintiff's Cross-Motion for Summary Judgment. In so holding, the Court found that Mesa's tender of its Unocal stock in the May 1985 exchange was an unorthodox transaction to which Section 16(b) liability did not attach.

On January 26, 1990, a status conference was held to determine the extent, if any, to which the January 19, 1990 Order was dispositive of the case. Mesa argued that since there was no applicable Section 16(b) sale, Plaintiffs could not state a claim upon which relief could be granted and therefore the case should be dismissed. Plaintiffs responded that although they respectfully disagreed with the merits of the Court's ruling, the Order itself did not dispose of the second event which might be considered a sale under Section 16(b): Mesa's conversion of the debt securities, received in exchange for its Unocal stock, into cash in July 1985. Since neither party had adequately addressed the July 1985 transaction in its motion, the Court requested additional briefing on this issue.

The parties have since submitted addendums to their original briefing papers. The Court construes these supplemental papers as part of the previously filed Cross-Motions for Summary Judgment. In essence, Plaintiffs assert that either the May 1985 exchange or Mesa's conversion of its debt securities for cash in July 1985 must be a sale pursuant to Section 16(b). Mesa submits that the May 1985 exchange is an unorthodox transaction which is not susceptible to Section 16(b) liability. Since Mesa sold its stock in an unorthodox transaction in May 1985, the Court need not examine subsequent events since Mesa could not have sold the same stock twice. In any event, Mesa asserts that Plaintiffs' claim based upon the July 1985 transaction is time-barred. Mesa further argues that this claim fails as a matter of law because transactions involving debt securities do not fall within the purview of Section 16(b).

In this case, both Plaintiffs and Defendants moved for summary judgment as a matter of law on facts which they agreed

were not in dispute. The principal question initially presented to the Court in the cross-motions concerned the application of the *Kern* exception to the May 1985 exchange. When the potentially dispositive nature of the cross-motions became clear in light of the Court's ruling in favor of Defendants, Plaintiffs directed the Court's attention to the July 1985 transaction. The Court has now considered both events to determine whether on the facts of this case a Section 16(b) sale exists as a matter of law.

Based on this review, the Court finds that Mesa's tender of its Unocal stock to Unocal in exchange for debt securities in May 1985 was an unorthodox transaction. In applying the *Kern* exception to the May transaction, the Court finds that although Mesa sold its Unocal stock within six months of its purchase, the sale is exempt from Section 16(b) liability. Such a finding precludes the need for the Court to consider subsequent events which absent the May sale might have provided the basis for a Section 16(b) sale.

Nevertheless, the Court proceeds to address the merits of the July 1985 transaction. Liberally interpreting Plaintiffs' Complaint, the Court finds that Plaintiffs' claim of liability premised upon the July 1985 conversion of debt securities into cash is not time-barred. However, as a matter of law, the Court cannot find that the July 1985 conversion is a Section 16(b) sale. Accordingly, the Court grants Defendants' Motion for Summary Judgment and denies Plaintiffs' Cross-Motion for Summary Judgment.

This Order replaces the January 19, 1990 Order Re: Cross-Motions for Summary Judgment. The present Order governs in this case. The Court deems the previous ruling on these cross-motions to be without force and effect.

STANDARD OF PROOF

"It is well settled that the filing of cross-motions for summary judgment, both parties asserting that there are no contested issues of material fact, does not vitiate the court's responsibility to

determine whether disputed issues of material fact are present. A summary judgment cannot be granted if a genuine issue as to any material fact exists." *United States v. Fred. A. Arnold, Inc.*, 573 F.2d 605, 606 (9th Cir. 1978). However, if a decision is to be reached by a court, and there are no issues of witness credibility, the court may conclude on the basis of affidavits, depositions, and other evidence that there are no genuine issues of material fact in dispute, even though the decision may depend on inferences to be drawn from what has incontrovertibly been proven. *Nunez v. Superior Oil Co.*, 572 F.2d 1119, 1123-24 (5th Cir. 1979).

Interpretation of a statute is appropriate for adjudication as a matter of law if all the facts before a court are undisputed. *See Smith v. Califano*, 597 F.2d 152, 155 (9th Cir 1979), *cert. denied*, 444 U.S. 980. The definition of the term "sale" and its application to a particular set of facts is like any other question of statutory construction, a question of law. *See e.g. Kern County Land Co.*, supra.

When both parties cross move on the same legal theory, a court's granting of one party's motion entails the denial of the adversary's motion. *See Schlycter v. Baker*, 580 F.2d 848, 849 (5th Cir. 1978). Since all the evidentiary facts are now before the Court, an interpretation of those facts in the process of determining the application of Section 16(b) as a question of law is appropriate in considering these summary judgment motions. *See Nunez v. Superior Court*, supra at 1123.

DISCUSSION

For the purpose of preventing the unfair use of information which may have been obtained by reason of a person's relationship to the issuing corporation, Section 16(b) of the Securities Exchange Act of 1934 provides that officers, directors, and holders of more than 10 percent of the listed stock of an issuing company shall be liable to the company for any profits realized from any purchase and sale or sale and purchase occurring within a period of six months. 15 U.S.C. (78p(b). Section 16(b) "was

designed to discourage corporate insiders from reaping profits from fluctuations in the price of the corporation's stock, that were predictable on the basis of inside information." *Provident Securities Co. v. Foremost-McKesson*, 506 F.2d 601, 604 (9th Cir. 1974), *aff'd* 423 U.S. 232, 96 S.Ct. 508, 46 L.Ed 2d 464 (1976).

Determination of Section 16(b) liability is premised on an objective test: If a sale and purchase by a ten percent shareholder results in a net gain, the gain is recoverable. *Arrow Distributing Corp. v. Baumgartner*, 783 F.2d 1274, 1281 (5th Cir. 1986). The short swing trader must disgorge any profits without proof of actual abuse of inside information and without proof of intent to profit on the basis of such information. *Kern County*, 44 U.S. at 595. If a transaction falls within the literal terms of the statute, liability is automatic. *Gund v. First Florida Banks, Inc.*, 726 F.2d 682, 686-87 (11th Cir. 1984); *Kay v. Scientex*, 719 F.2d 1009, 1013 (9th Cir. 1983).

In drafting Section 16(b), Congress "recognized that short-swing speculation by stockholders with advance, inside information would threaten the goal of the Securities Exchange Act to 'insure the maintenance of fair and honest markets'. *Kern County*, supra at 1743 citing 15 U.S.C. sec. 78b. Congress deemed the stringent requirements of Section 16(b) necessary to eliminate undue problems of proof and to have a general rule to take all possible profit out of those transactions in which the possibility of abuse was intolerably great. *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 422, 92 S.Ct. 596, 599, 30 L.Ed.2d 575 (1972).

Despite the mandatory language of Section 16(b), the Supreme Court in *Kern County* recognized that "courts have wrestled with the question of inclusion or exclusion of certain 'unorthodox' transactions." 93 S.Ct. at 1744. "Transactions which on their face do not clearly involve a purchase and a sale and which therefore require analysis ... to determine if the possibility for speculative abuse exists, have been described as 'unorthodox'." *Portnoy v. Memorex Corp.*, 667 F.2d 1281, 1285 (9th Cir. 1982) (Reinhardt, Chief Judge, Concurring). To

account for these unorthodox transactions and to prevent an overly broad interpretation of Section 16(b), the Supreme Court adopted a more "pragmatic approach" to the application of the statute. *Kern County Land Co.*, supra at 1744.

In *Kern County*, the Supreme Court stated in pertinent part:

> In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire whether the transaction [served] as a vehicle for the evil which Congress sought to prevent — the realization of short-swing profits based upon access to inside information — thereby endeavoring to implement congressional objectives without extending the reach of the statute beyond its intended limits.

Id. at 1744-45. In light of the strict terms of the statute, where alternative constructions of the terms of Section 16(b) are possible, the statute should be applied only where its application would serve Congress' goals. *Id.*, at 1745. Thus, Section 16(b) is applied automatically only to 'orthodox' transactions as defined by case law; unorthodox transactions are actionable under Section 16(b) only if a court's pragmatic analysis demonstrates that the transaction presented an opportunity for speculative abuse.

I. The May 1985 Unocal Exchange Offer

In *Kern County*, the Supreme Court established a two part test to determine the applicability of Section 16(b) liability to a purported sale: (1) Was the stock "sold" in an unorthodox transaction?[7] and (2) Was there any opportunity for the party to

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[7] It appears that to be a sale under Section 16(b), there must be some change in either the character of the investment or the nature of the market risk assumed. *Rothenburg v. United Brands Co.*, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) 96,045 (S.D.N.Y. 1977). There is little question that the risk associated with Mesa's Unocal investment, and the nature of the investment itself, changed after Mesa exchanged its stock for debt securities. In this case, however, the question is not whether Mesa sold its Unocal stock in May 1985, but rather whether the stock was sold in an unorthodox transaction.

engage in the kind of speculative abuse of inside information which Section 16(b) was designed to prevent? *Id.* at 1744-45. A finding that the Mesa-Unocal exchange was in fact an unorthodox transaction would in essence dispose of the case since there would be no applicable sale to which section 16(b) liability could attach.

A simple cash for stock transaction is "clearly within the purview of [section] 16(b)". *Kern County*, 411 U.S. at 593. Transactions which have been found to be unorthodox include "stock conversions, exchanges pursuant to mergers and other corporate reorganizations, stock reclassifications, and dealings in options, rights, and warrants." *Id.* citing 2 L. Loss, *Securities Regulation* 1069 (2d ed. 1961). Although the Ninth Circuit has determined that this list is not all inclusive, the Court has not applied the *Kern* exception to transactions which are essentially cash for stock and orthodox in all other respects. *See Provident Securities Co. v. Foremost-McKesson*, supra at 604-605 (The court found "no meaningful distinction between consideration in the form of cash and consideration in the form of corporate assets.").

Any mechanical application of Section 16(b) is limited to "garden variety transaction[s]". *Whittaker v. Whittaker*, 639 F.2d 516, 523 (9th Cir.), *cert. denied*, 454 U.S. 1031 (1981). The fact that stock is exchanged for cash or a cash equivalent within six months, however, is not determinative of the question of unorthodoxy. The critical issue is not the form of consideration paid for the stock but rather the nature of the disposition of the stock. *See Colan v. Prudential-Bache Sec. Inc.*, 577 F. Supp. 1074, 1082 (N.D.Ill. 1983). Similarly, profit is not in and of itself an indication of Section 16(b) liability.

Unocal claims that Mesa exchanged its stock for a cash equivalent — debt securities — which were immediately convertible into cash. Mesa responds that its sale of Unocal stock pursuant to a settlement agreement was part of a corporate reorganization which was an unorthodox transaction.

The Unocal exchange offer was a type of corporate reorganization commonly described as a recapitalization. A recapitalization is in essence a "reshuffling of a capital structure, within the framework of an existing corporation." *Helvering v. Southwest Consol. Corp.*, 315 U.S. 194, 202, 62 S.Ct. 546, 552, 86 L.Ed. 789 (1942). Commentators have generally classified exchange offers as a type of corporate recapitalization:

> A recapitalization may . . . be structured as an exchange offer in which the company offers to purchase a certain number of its shares in exchange for cash or debt securities. The transactions involving Phillips Petroleum, Unocal, and Union Carbide are the most celebrated examples of this structure. Notably, this structure has been largely used in response to hostile tender offers.

Ledderman & Goroff, *Recapitalization Transactions*, 19 Rev. Sec. & Commodities Reg. (1986).[8] In at least one case, *Rothenburg v. United Brands Co.*, a court has held that an exchange of stock in a recapitalization following a tender offer was not a sale pursuant to Section 16(b). [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) 96,045 (S.D.N.Y. 1977).

Mesa's tender of its Unocal stock for debt securities in response to Unocal's exchange offer was not a garden variety stock for cash transaction. In this case, Mesa's "sale" of its Unocal stock was in response to Unocal's direct solicitation for the stock. Mesa's stock was tendered in conjunction with other Unocal shareholders and in the same proportion. Absent Unocal's consent to Mesa's

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[8] *See also* A. Fleisher, 1 *Tender Offers: Defenses, Responses and Planning*, 388.172 (Supp. 1987) ; Block & Hoff, *Recapitalizations and Restructurings* 186, reprinted in Block & Radin, *The Business Judgment Rule in Derivative and Corporate Takeover Litigation*, Hostile Battles for Corporate Control 1989 (PLI Corporate Law & Practice Series No. 633, 1989); Nathan & Sobel, *Corporate Stock Repurchases in the Context of Unsolicited Takeover Bids*, 35 Bus.Law. 1545 (July 1980); Fogelson, *Recent Takeover Defense Strategies*, Hostile Battles for Corporate Control 1986 at 467 (PLI Corporate Law & Practice Series No. 513, 1986).

participation in the exchange offer, Section 16(b)'s six month provision would have precluded Mesa from disposing of this stock in a more traditional sale transaction. A sale pursuant to a recapitalization of this type is outside the scope of the definition of a Section 16(b) "sale". The Court finds that Mesa's exchange of its Unocal stock for debt securities in the May 1985 exchange was an unorthodox transaction under *Kern County*; therefore, the transaction deserves closer scrutiny to determine whether the potential for abuse of inside information existed.

The potential for abuse of inside information is considered only after a transaction is found to be unorthodox or borderline. *Whittaker v. Whittaker*, 639 F.2d 516, 522 (9th Cir.), *cert. denied* 454 U.S. 1031, 102 S.Ct. 566, 70 L.Ed.2d. 473 (1981). If a transaction falls within the literal terms of the statute, it is irrelevant that the defendant actually received or used inside information. *See e.g. National Medical Enterprises, Inc. v. Small*, 680 F.2d 83, 84 (9th Cir. 1982). However, "because of the mechanical application of Section 16(b) imposing liability without fault on transactions within its scope, courts more recently have been hesitant to bring borderline transactions under that scope . . . where congressional intent is unclear and the transaction in question was not of a type giving rise to speculative abuse." *Whittaker v. Whittaker.*, supra at 522; *See also Blau v. Lamb*, 363 F.2d 507, 516 (2d Cir. 1966).

Congress adopted Section 16(b) to prevent insiders of publicly held corporations, who had advance knowledge of facts or access to information not available to other investors that, upon public disclosure, would produce either a rise or fall in the market price of the stock, from realizing a personal profit by buying or selling the corporation's shares before the good or bad news was made public. *Reliance Electric Co. v. Emerson Elec. Co.*, 404 U.S. 418, 92 S.Ct. 596, 599 (1972); *Arrow Distributing Corp.*, supra at 1277. The Ninth Circuit has defined inside information for Section 16(b) purposes as "the kind of information that is commonly reserved for company management and is thus the type of information that would 'aid [one] if he engaged in

personal market transactions.' " *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Livingston*, 566 F.2d 1119, 1123 (9th Cir. 1978).

In determining whether a transaction has the potential for speculative abuse, a court must look at two factors: 1) Could the defendant reasonably be expected to have had access to inside information? and 2) Did the defendant initiate the transaction voluntarily? *Provident Securities Co. v. Foremost-McKesson, Inc.*, 506 F.2d 601 (9th Cir. 1974) citing *Kern County*, supra at 596-600. Contrary to Mesa's contention, the Court must focus not on Mesa's literal access to inside information, but rather on Mesa's potential for speculative abuse of inside information. *Provident Securities*, supra at 605. A hostile relationship may justify the conclusion that there was only a remote possibility of access to inside information. *See e.g. Kern Co.; American Standard Inc. v. Crane Co.*, 510 F.2d 1043 (2d Cir. 1974), *cert. denied* 421 U.S.(1975).[9]

Unocal claims that Mesa had access to important information not available to the general public regarding, *inter alia*, the various actions it intended to take in buying and selling the Unocal stock, the timing of such actions, and the status and likely outcome of its negotiations with Unocal. By initiating a tender offer, Unocal contends that Mesa caused Unocal to pursue a financial policy from which Mesa benefited.

However, on the facts of this case, Mesa was a true outsider despite its ten percent stockholder status. Both Mesa and Unocal have admitted that "unmitigated hostility" characterized the relationship between the two parties. Such hostility alone may negate the existence for potential of speculative abuse. *See Kern*, supra at 598; *Crane*, supra at 1054. Furthermore, when Unocal

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[9] However, some courts have found that voluntary exchanges of stock for cash or cash equivalents may be subject to Section 16(b) regardless of "unmitigated hostility" or actual access to inside information. *Texas Int'l Airlines*, 714 F.2d 533, 538-40 (5th Cir. 1983), *cert. denied*, 465 U.S. 1052 (1984); *Bunker Ramo-Eltra Corp. v. Fairchild Indus.*, 639 F.Supp. 409, 418 (D.Md. 1986).

was still a defendant in this case, Unocal denied that Mesa had any access to inside information.

Mesa was not privy to any information which was not generally available to other Unocal shareholders. Full disclosure was made to Unocal's shareholders regarding Mesa's tender offer and Unocal's counter exchange offer. The information which Mesa received was in no way increased by its making a tender offer. *See American Standard, Inc. v. Crane Co.*, supra at 1054. In light of the hostility between Mesa and Unocal, Mesa had no "unfair advantage" over other shareholders. *Pay Less Drug Stores*, 579 F.Supp. at 1401. In fact, the "sharpness of an open contest for control would make [Mesa] even more an adversary." *American Standard, Inc. v. Crane Co.*, supra at 1055. Thus, there is no evidence that inside information was available to Mesa by virtue of its stock ownership or that Mesa had the potential for speculative abuse of inside information. *Kern County*, supra; *see also Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232, 237, 96 S.Ct. 508, 513, 516, 46 L.Ed.2d. 503 (1976).

Courts have also traditionally required a showing that a transaction was involuntary in order to justify the application of the *Kern* exception.[10] In adopting this standard, the Ninth Circuit has specified that "[i]mplicit in the [requirement of voluntariness] is the limitation that the *Kern County* rule of leniency should not be applied where the defendant could have avoided

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[10] Most courts have interpreted *Kern County* to require that a sale be involuntary in order to be unorthodox. *See Kay v. Scientex Corp.*, 719 F.2d 1009, 1013 (9th Cir. 1983); *Texas Int'l Airlines v. National Airlines*, 714 F.2d 533, 540 (5th Cir. 1983) (under *Kern*, voluntary transactions should not be found to be unorthodox); *Tyco Laboratories, Inc. v. Cutler-Hammer, Inc.*, 490 F.Supp. 1, 6 (S.D.N.Y. 1980) (for *Kern* exception to apply, transaction must be involuntary). *But see Pay Less Drug Stores v. Jewel Cos.*, 579 F. Supp. 1396 (N.D.Cal. 1984) (voluntary decision to exercise option for cash was an unorthodox transaction because it was not based upon inside information which insider could use to gain an unfair advantage over other shareholders).

section 16(b) liability without serious detriment." *Provident Securities,* supra at 605.

In the context of Section 16(b), involuntariness generally requires an inability of the unsuccessful party to control the terms, conditions, and timing of a sale. *See Heublein, Inc. v. Gen'l Cinema Corp.,* 559 F.Supp. 692, 699-700 (S.D.N.Y.), *aff'd* 722 F.2d 29 (2d Cir. 1983), *cert. denied* 465 U.S. 1066 (1984). As long as a seller retains any control over whether or when a transaction takes place, the sale is voluntary. *Sprague Electric Co. v. Mostek Corp.*, 488 F.Supp. 842, 845 (N.D.Tex. 1980). In *Sprague*, the court specifically noted that had the defendant sold his stock pursuant to a stockholders' agreement, which would have essentially deprived the stockholder of his control, the sale would have been involuntary.

The key factor is whether the insider can control the transaction, "not whether the insider has any control over *any method* of disposing of his stock. *See* A. Jacobs, *Section 16 of the Securities Exchange Act*, 3-136 to 3-137 (1989)(emphasis in original). Even though the Supreme Court labeled the transaction in *Kern County* involuntary, the Court recognized that Occidental had an alternative, ie. selling the stock for cash prior to the merger; however, the Court held that this was not a "realistic alternative" since the defendant would have been subject to Section 16(b). 411 U.S. at 600. Other courts have placed similar emphasis on the quality of an insider's choice. *See Heublein, Inc. v. General Cinema Corp.* 559 F.Supp. 692, 699-700 (S.D.N.Y.), *aff'd*, 722 F.2d 29 (2d Cir. 1983), *cert. denied*, 465 U.S. 1066 (1984) ("once the merger was approved, General Cinema, like Occidental in *Kern County*, was left with no viable alternatives"); *Abrams v. Occidental Petroleum Corp.*, 450 F.2d 157 (2d Cir. 1971), *aff'd*, 411 U.S. 582 (1973) (discussing "economically forced exchange" in connection with the pragmatic analysis to determine purchase or sale); *Colan v. Prudential-Bache Sec. Inc.*, 577 F.Supp. 1074, 1083 (N.D.Ill. 1983) (merger gave insider "no real choice").

In some cases, an otherwise voluntary transaction may be deemed involuntary if the defendant would have suffered serious economic loss had the transaction not taken place. Mesa's desire to participate in Unocal's exchange offer did not simply result from a decision that it was too unprofitable to pursue the proxy contest. Mesa's stock holdings would have seriously declined in value, approximately $450 million, if it had not negotiated with Unocal to exchange its shares. *Cf. Lane Bryant, Inc. v. Hatleigh Corp.*, 517 F.Supp. 1196, 1200 (S.D.N.Y. 1981) (since defendant simply decided the proxy contest was too costly, the court found that the *Kern* exception did not apply to the sale of defendant's stock).[11]

In an action brought by a tender offeror to enjoin the target corporation from pursuing a self tender, the Delaware Chancery Court found that a technically optional recapitalization in the form of a self-tender by a company defending against a takeover attempt was coercive because no rational shareholder could afford not to tender in light of the disparity between the self-tender price and the anticipated post-recapitalization value of the remaining shares; as a result, the Delaware court concluded that a shareholder "acting with economic rationality [had] no effective choice" but to participate in the recapitalization. *AC Acquisitions Corp. v. Anderson, Clayton & Co.*, 519 A.2d 103, 113-14 (Del. Ch. 1986). Similarly, the structure of Unocal's exchange offer rendered Mesa's participation therein financially necessary in substance even though it was voluntary in form. *cf. City Capital Assoc. v. Interco, Inc.*, 551 A.2d 787, 797 (Del. Ch. 1988).

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[11] Plaintiffs argue that Mesa would have been able to turn its paper loss into a $532 million profit by December 1989 if Mesa had held on to its Unocal stock. However, the fact that this loss may have been recovered by Mesa if Mesa had pursued its Unocal investment is not relevant to an analysis of voluntariness. The Court must be concerned with the facts as they existed at the time Mesa had to decide whether to participate in the exchange.

Unocal initiated the exchange offer as a defensive tactic to extricate Mesa from Unocal. Several lawsuits resulted because Unocal chose to exclude Mesa from the exchange offer. After the Delaware Supreme Court placed its imprimatur on Unocal's exclusion of Mesa, Unocal instead chose to pursue a settlement agreement with Defendants. Absent Unocal allowing Mesa to participate in the exchange, Mesa would have been excluded.

By virtue of Unocal's attempt to exclude Mesa from participating in its exchange offer and ultimately the courts' approval of this exclusion, Mesa was faced with the prospect of huge economic losses. Unless Mesa was able to tender its Unocal stock as part of the exchange offer, Mesa risked the loss of up to $450 million. Mesa did not possess the alternative of selling to another buyer since such a sale would clearly have been prohibited by Section 16(b). Simply holding the stock was not a reasonable alternative. Furthermore, while Mesa willingly tendered its Unocal stock for debt securities, Mesa had no control over its ability to participate in the exchange. Unocal had the power to exclude Mesa at will. Although Mesa sought to participate in the exchange offer, Mesa's role was in essence involuntary.[12]

Mesa's exchange of its Unocal stock pursuant to the settlement agreement with Unocal was not a "garden variety" cash for stock transaction. The sale was part of an overall recapitalization initiated by Unocal. Mesa did not benefit from the use of inside information and had no potential for speculative abuse of inside information. Although Mesa's tender of its Unocal stock in exchange for debt securities can be considered a "sale", the Court

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[12] Plaintiffs contend that statements by T. Boone Pickens in his book *Boone* are the best evidence that Mesa had alternatives. Plaintiffs assert that such admissions are dispositive on the issue of voluntariness. The Court, however, finds the contrary. Mr. Pickens' statements reflect the belief that Mesa had the potential both to gain and to lose significant money. In light of the self-aggrandizement in which Mr. Pickens partakes, the Court treats his admissions accordingly. In sum, the facts in this case support a finding that Mesa's participation in the Unocal exchange was essentially involuntary.

finds that the *Kern County* unorthodox transaction exception applies to the May 1985 exchange offer to exempt it from Section 16(b) liability.

II. The July 1985 Conversion Of Debt Securities Into Cash

There is no question that Mesa's "cash-out" of its debentures was entirely voluntary. Furthermore, it is clear that this transaction occurred within six months of the March stock purchases that put Mesa over the 10% ownership mark. Since neither party contends that this event was or was not an unorthodox transaction, any liability premised on this transaction depends entirely upon the straight application of Section 16(b).[13]

As a threshold matter, however, the Court must determine whether this claim is time-barred, as Defendants contend. Mesa argues that Plaintiffs' matching of the conversion of the debt securities with Mesa's purchase of its Unocal stock to establish Section 16(b) liability is a new cause of action which has not been previously pled. Section 16(b) expressly provides that "no . . . suit shall be brought more than two years after the date such profit was realized." 15 U.S.C. sec. 78p(b). Plaintiffs respond that the allegation in their Complaint that "[w]ithin a period of less than six months in 1985, Partners, while a 10% statutory insider of Unocal, purchased and sold Unocal common stock at a substantial profit" placed Mesa on notice of the July 1985 transaction.

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[13] Mesa argues that its tender of Unocal stock in the May 1985 exchange was the sale which must be considered for the purpose of Section 16(b) liability. A finding that the exchange was an unorthodox transaction does not alter the fact that Mesa "sold" its Unocal stock. For this reason, Mesa contends that it did not possess any securities subject to Section 16(b) after this date, and thus, the Court need not address the July 1985 conversion. The Court finds this argument persuasive. However, for the purposes of providing a complete and thorough record, the Court proceeds to consider the merits of the July 1985 transaction.

Unless the Court determines that Plaintiffs' Complaint adequately encompasses the July 1985 transaction as a possible 16(b) sale, Plaintiffs' claim which is premised on this transaction is time-barred. Even if Mesa did not realize profit until July 1985, any claim based on the transaction had to be initiated by July 1987. As Plaintiffs note, the next specific reference to this transaction as an alternative basis for Section 16(b) liability occurred in October 1989.

Even if the Court determines that the Complaint adequately states a claim that the July 1985 transaction is a 16(b) sale, Defendants contend that Plaintiffs have waived this claim by their failure to incorporate it into the Pretrial Order. "[P]articular evidence or theories which are not at least implicitly included in the order are barred unless the order is first 'modified to prevent manifest injustice'." *United States v. First Nat. Bank of Circle*, 652 F.2d 882, 886-87 (9th Cir. 1981) citing Fed.R.Civ.P.16.

Plaintiffs provide five specific instances in which they raised this claim: (1) Plaintiffs' Pretrial memorandum,[14] (2) Plaintiffs' Motion in Limine,[15] (3) The Pretrial Order filed November 9,

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[14] Plaintiffs' Pretrial memorandum merely states that "[o]n July 3, 1985, Mesa received these debt securities and sold them for $589 million . . ." Plaintiffs apparently rely on their use of the word "sold" as the basis of their claim.

[15] The most direct argument that the July transaction might be an applicable 16(b) sale was presented in Plaintiffs' in limine motion on this issue. In Footnote No. 5, Plaintiffs noted:

> Mesa received the bonds on July 3, 1985 and immediately sold them for approximately $589 million . . . Thus, although the debt securities were a cash equivalent sufficient to defeat the invocation of the exception here, Mesa actually cashed in the debt securities within six months.

Then, later in the in limine motion, Plaintiffs assert:

> The "recapitalization" cases are wholly unavailing for yet another reason. In each of the five cases discussed above, the plaintiff

1989, (4) Plaintiffs' 1292(b) Opposition filed October 26, 1989, and (5) The deposition of Plaintiffs' damage expert. Plaintiffs assert that they have not waived this claim because they incorporated it into the Pretrial Order by reference. Even if the Court finds to the contrary, Plaintiffs request that the Court modify the Pretrial order pursuant to Fed. R. Civ. P. 16(e) to prevent manifest injustice.

The Pretrial Order does contain a catch-all reference to the Plaintiffs' Memorandum of Contentions. Thus, at least implicitly, the Pretrial Order refers to a document wherein Plaintiffs raise a Section 16(b) claim based upon the July 1985 transaction. In light of the congressional policy to trap valid short-swing profits, the Court should give the benefit of any doubt to a plaintiff in his or her pleading of a Section 16(b) claim. As a result, the Court concludes that the language of Plaintiffs' Complaint which refers to the purchase and sale of *stock*, which technically appears to exclude consideration of a sale of debt securities, is not determinative on this statute of limitations question.

Construing the Complaint and the Pretrial order liberally, the Court will not hold that Plaintiffs' claim that the July 1985 transaction is a section 16(b) sale is time-barred. Although Plaintiffs' Complaint can hardly be characterized as a model complaint, the Court is unwilling at this stage to dispose of the

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attempted to use the reclassification or recapitalization as either the "purchase" or "sale" necessary to establish Section 16(b) liability. (footnote omitted). In the present case, Mesa sold the debt securities for cash within six months of the date it crossed Section 16(b)'s ten percent threshold. Thus, even assuming, *arguendo*, that Mesa's change from equityholder to debtholder was merely a change of form and not substance, Mesa still went ahead and converted the bonds to cash on the day it received them, well within the six-month window. Unlike the cases cited by Mesa, the present action involves a cash purchase and a cash sale within six months, regardless of whether the exchange of stock for bonds was a Section 16(b) sale. Such transactions always fall within the ambit of Section 16(b).

claim on technical pleading grounds. For the purposes of these motions, the Court construes the Complaint to cover the July 1985 transaction since as a matter of law, Plaintiffs' attempt to apply Section 16(b) to this transaction must fail.

Assuming *arguendo* that the July 1985 claim is adequately pled and thus not time-barred, the Court now turns to the merits of this transaction as a Section 16(b) sale. Once again, the relevant facts are undisputed. On May 20, 1985, Mesa, while a ten percent shareholder, exchanged 7,846,705 shares of Unocal stock for senior notes secured by Unocal common stock worth approximately $75 per share. Mesa remained a ten percent shareholder after this exchange. On July 3, 1985, while a beneficial owner, Mesa cashed in the debentures for approximately $589 million, or $75 per share. There is no question that Mesa's decision to convert its debt holdings into cash was voluntary.

Plaintiffs now argue that the critical fact which the Court must consider is that Mesa went from a multi-million dollar equity position to cash as a result of two voluntary investment decisions within six months while a more than 10% shareholder in Unocal. Plaintiffs contend that Mesa's profit of $96.8 million is subject to Section 16(b) regardless of whether the exchange of stock for debentures in May 1985 is viewed as an unorthodox transaction and regardless of the fact that the securities which were ultimately converted into cash were debt, not equity securities. In essence, Plaintiffs urge that Mesa's interim exchange of stock for debt securities cannot exempt any short swing profits from Section 16(b).

In arguing this position, Plaintiffs seek to rearticulate the statutory provisions of Section 16(b). The plain language of Section 16(b) of the Securities and Exchange Act of 1934 provides in pertinent part:

> For the purpose of preventing unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase or sale, or any

> sale and purchase, of any *equity* security of such issuer . . . shall inure to and be recoverable by the issuer . . .

15 U.S.C. section 78p(b) (emphasis added). The term "equity security" refers to "any stock or similar security; or any security convertible, with or without consideration, into such a security . . ." 15 U.S.C. section 78(c)(11) Thus, the term does not encompass debt securities which do not display any features of convertible securities. *See also* 17 C.F.R. Ch.II section 240.3all-1 (1989).

The debt securities in this case were typical debt instruments — unqualified obligations on the part of Unocal to pay a fixed sum at a fixed maturity date along with periodic interest payments, regardless of the status of Unocal's common stock. *See United States v. Evans*, 375 F.2d 730, 731 (9th Cir. 1967). The legislative history of Section 16(b) confirms that Congress intentionally restricted the statute's coverage to exclude non-convertible debt instruments. *See e.g.*, P. Romeo & A. Dye, *Section 16 Reporting Guide*, section 7.01 [1] (1989):

> The legislative history of Section 16 reveals that the drafters originally intended to apply the provision to any person who owned more than five (later ten) percent of *any* class of securities, so long as the issuer had at least one class of securities registered on a national stock exchange. Objections to this all-inclusive provision were raised at the congressional hearings on the 1934 Act, principally on the ground that ownership of debt securities rarely gave the holder control over the issuer or its policies. Moreover, Congress appears to have recognized that transactions in pure debt securities rarely are susceptible to speculative abuse, since such securities generally trade on the basis of their inherent characteristics (*e.g.*, yield, maturity, redemption provisions, etc.) rather than in reaction to corporate developments. As a result, Congress decided to restrict the coverage of Section 16 solely to equity securities.

(emphasis in original). From the beginning, the Securities and Exchange Commission has consistently held that non-convertible

debt securities are not equity securities for section 16(b) purposes.[16]

Each of the cases cited by Plaintiffs for the proposition that a purchase of stock may be matched with a sale of debt for Section 16(b) purposes is easily distinguishable. Each involves the conversion of an equity security into another equity security or the sale of equity for cash. *See Blau v. Lamb*, 363 F.2d 507 (2d Cir. 1966); *Rothenburg v. United Brands Co.*, supra; and *American Standard, Inc. v. Crane Co.*, 510 F.2d 1043, 1063 (2d Cir. 1974), *cert. denied*, 421 U.S. 1000, 95 S.Ct. 2397, 44 L.Ed.2d 667 (1975). In this case, the July 1985 transaction involved debt, not equity securities. While courts considering potential 16(b) transactions have held that an interim unorthodox transaction within the statutory six month period may be disregarded as a step in the process, *see Blau v. Max Factor & Co.*, 342 F.2d 304, 308 (9th Cir. 1965); and *Rothenburg v. United Brands Co.*, supra, the final disposition of securities in those cases still involved equity, not debt.

The length of an insider's investment commitment is not always controlling. The liquidation of an investor's stock holdings within six months does not translate automatically into Section 16(b) short-swing profits. Profits derived from two investment decisions within the statutory six month period must be disgorged only if both the "purchase" and "sale" are governed by Section 16(b). The final disposition of a security does not

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[16] *See e.g.*, Exchange Act Release No. 2575 (July 5, 1940) (none of the various debentures involved "is an 'equity' security as defined in Section 3(a)(11) . . . and, hence, Section 16 . . . would be inapplicable to transactions therein by the officers, directors, and stockholders of the respective issuers."); Exchange Act Release No. 2937 (June 19, 1941) (Section 16 inapplicable to mortgage bonds since the subject securities were not equity securities.).

become a Section 16(b) sale merely because it occurs within six months of the purchase of the original equity security.[17]

Plaintiffs' arguments are without foundation in precedent or otherwise. The Court finds that Mesa sold its Unocal stock to Unocal in exchange for debt securities in May 1985. While Mesa's investment commitment with respect to Unocal's equity securities lasted for a period of less than six months, that commitment terminated in an unorthodox transaction which carried no potential for speculative abuse. Because the Court finds this transaction to be unorthodox, any profits realized as a result of this transaction do not fall within the purview of Section 16(b).

After the May exchange, Mesa retained debentures which are not statutorily controlled to the same extent as equity securities. Consequently, when Mesa converted these debt holdings into cash, Section 16(b) did not control the transaction. In light of the clear statutory language precluding 16(b) coverage for transactions in debt, Plaintiffs' contention that the July 1985 conversion is a Section 16(b) sale must fail as a matter of law. This Court will not recharacterize a disposition of debt securities as a 16(b) sale simply because it follows an unorthodox transaction. *Cf. Portnoy v. Memorex corp.*, 667 F.2d 1281, 1284 (9th Cir. 1982) (refusing to recharacterize a transaction to impose Section 16(b) liability without specific congressional authority).

Plaintiffs' argument that Mesa's unclean hands precludes consideration of the purported equities in Mesa's favor is misplaced. Profit as a corporate goal and questionable takeover tactics are not the "evils" which Section 16(b) addresses. "If there are evils to

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[17] The Court does not consider the SEC regulations to be persuasive. While the Commission has the authority to exempt from Section 16(b) specific transactions that the SEC considers beyond the comprehension of the statute, the SEC's failure to address every conceivable transaction does not render those unaddressed automatically susceptible to 16(b). These rules are intended to narrow rather than broaden the scope of Section 16(b).

be redressed by way of deterring those who would make tender offers, [section] 16(b) does not appear . . . to have been designed for this task." *Kern County*, supra at 1746.

Thus, for all of the reasons explained herein, the Court finds that neither the May 20, 1985 exchange nor the July 3, 1985 conversion of debt securities into cash was a sale within the meaning of Section 16(b). Since Plaintiffs cannot establish a sale for the purpose of Section 16(b) liability, they cannot sustain their claim against Defendants. Accordingly, the Court grants Defendants' Motion for Summary Judgment and denies Plaintiffs' Cross-Motion for Summary Judgment.

IT IS SO ORDERED.

Dated: April 10, 1990

/s/ JOHN G. DAVIES

John G. Davies
United States District Judge

Appendix C

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

DAVID COLAN,
Plaintiff,
UNOCAL CORPORATION,
Plaintiff/Appellant,
vs.
MESA PETROLEUM CO., *et. al.*,
Defendant/Appellee,

CA# 90-55641
DC# CV-89-02901-JPV

DAVID COLAN,
Plaintiff/Appellant,
vs.
MESA PETROLEUM CO., *et al.*,
Defendant/Appellee,

CA# 90-55643
DC# CV-89-02901-JPV
ORDER

BEFORE: ALARCON, Circuit Judge

The motion for stay of mandate until January 31, 1992 is Granted.

Appendix D

[Full text of § 16(a), (b), 15 U.S.C. 78p(a), (b)]

(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 78*l* of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 78*l*(g) of this title, or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the

issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

Appendix E

Excerpts from *Kern County*

Congress recognized that short-swing speculation by stockholders with advance, inside information would threaten the goal of the Securities Exchange Act to "insure the maintenance of fair and honest markets." 411 U.S. at 591.

In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent — the realization of short-swing profits based upon access to inside information — thereby endeavoring to implement congressional objectives without extending the reach of the statute beyond its intended limits. 411 U.S. at 594-95 (footnote omitted).

[D]id the exchange involve a "sale" of Old Kern shares within the meaning of § 16(b)? We agree with the Court of Appeals that it did not, for we think it totally unrealistic to assume or infer from the facts before us that Occidental either had or was likely to have access to inside information, by reason of its ownership of more than 10% of the outstanding shares of Old Kern, so as to afford it an opportunity to reap speculative, short-swing profits from its disposition within six months of its tender-offer purchases. 411 U.S. at 596.

There is no basis for finding that, at the time the tender offer was commenced, Occidental enjoyed an insider's opportunity to acquire information about Old Kern's affairs. 411 U.S. at 596-97.

If its takeover efforts failed, it is argued, Occidental knew it could sell its stock to the target company's merger partner at a substantial profit. Calculations of this sort, however, whether speculative or not and whether fair or unfair to other stockholders or to Old Kern, do not represent the kind of speculative abuse at which the statute is aimed, for they could not have been based on inside information obtained from substantial stockholdings that did not yet exist. Accepting both that Occidental made this very

prediction and that it would recurringly be an accurate forecast in tender-offer situations, we nevertheless fail to perceive how the fruition of such anticipated events would require, or in any way depend upon, the receipt and use of inside information. 411 U.S. at 597 (footnote omitted).

We are quite unconvinced, however, that the situation had changed materially with respect to the possibilities of speculative abuse of inside information by Occidental. 411 U.S. at 598.

The possibility that Occidental had, or had the opportunity to have, any confidential information about Old Kern before or after May 11, 1967, seems extremely remote. 411 U.S. at 598.

There is, therefore, nothing in connection with Occidental's acquisition of Old Kern stock pursuant to its tender offer to indicate either the possibility of inside information being available to Occidental by virtue of its stock ownership or the potential for speculative abuse of such inside information by Occidental. 411 U.S. at 599.

Supreme Court, U.S.
FILED
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No. 91-1451

In The

Supreme Court of the United States

October Term, 1991

MESA PETROLEUM CO., et al.,

Petitioners,

v.

DAVID COLAN and UNOCAL CORPORATION,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Court

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QUESTION PRESENTED

Pursuant to this Court's Rule 15.1, respondents point out that petitioner's statement of the question presented is erroneous. Petitioner's statement asserts that Mesa's decision to exchange its stock was economically coerced, that the exchange occurred pursuant to a corporate recapitalization, and that there was no potential for speculative abuse of inside information. As the Court of Appeals held, "the evidence is undisputed that the Mesa Defendants made a voluntary business decision to persuade Unocal to permit them to participate in the corporation's self-tender offer" after "the Mesa Defendants shrewdly calculated their options." (Pet. at 34a.) Accordingly, the question actually presented is that framed by the Court of Appeals in issuing its ruling:

Is "an exchange of common stock for a negotiable debt security pursuant to a tender offer . . . a 'sale' within section 16(b)"? (Pet. at 7a.)

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No. 91-1451

In The

Supreme Court of the United States

October Term, 1991

MESA PETROLEUM CO., et al.,

Petitioners,

v.

DAVID COLAN and UNOCAL CORPORATION,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Court

JOINT BRIEF FOR RESPONDENTS IN OPPOSITION

Unocal[1] files this brief in opposition to Mesa's[2] petition for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit.

Nothing in the Court of Appeals' decision merits review on certiorari. The Ninth Circuit's opinion is a straightforward

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[1] In this brief we follow the practice of the parties and refer to both Unocal Corporation and David Colan, plaintiffs in the underlying action, as "Unocal." Pursuant to Rule 29.1 of this Court, Unocal informs the Court that it owns approximately 96% of Unocal Exploration Corporation which is publicly traded (symbol "UXC"); all other Unocal subsidiaries are wholly owned.

[2] Again pursuant to the custom and practice in this case, we refer to all petitioners – Mesa Petroleum Co., Mesa Southern Co., Mesa Asset Co., CY-41, Inc. and JACK-41, Inc. – as "Mesa."

application of the principles enunciated by this Court in *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973). Those principles have been consistently applied in a myriad of decisions throughout the federal judiciary, including a unanimous body of cases refusing to create a section 16(b) exemption for short-swing profits garnered by "defeated" tender offerors.

Mesa's pronouncements of "sharp conflicts" between the Court of Appeals' decision and the law of other circuits can only be attributed to the "overzealous advocacy" for which Mesa was chastised by the Ninth Circuit. (Pet. at 18a.) There is no conflict. There is no split among the circuits.

Several of the handful of cases cited in the petition predate *Kern*. By definition they can create no conflict regarding the application of *Kern*. Virtually all of the cases relied upon by Mesa pertain to corporate reorganizations and stock reclassifications that changed the form of the insider's equity investment. The insider technically became a "seller," without any volitional act on its part and without altering the fundamental nature of the investment.[3] That is not what happened here.

Mesa made a calculated and wholly voluntary business decision to exchange its equity investment for notes obtained from Unocal in a tender offer. The exchange was made pursuant to a separate agreement negotiated exclusively between Mesa and Unocal, which, according to Mesa's chairman, brought Mesa a great "victory" in the form of an $83 million after-tax profit.

STATEMENT OF THE CASE

Section 16(b) of the Securities Exchange Act of 1934 requires disgorgement of "short-swing" profits realized by an

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[3] By and large these situations are now dealt with by SEC rules pursuant to the authority specifically granted to the Commission to exempt categories of transactions "not comprehended within the purpose of" § 16(b). 15 U.S.C. § 78p(b). See, e.g., Rule 16b-9, 17 C.F.R. § 240.16b-9 (1991) ("Exemption from section 16(b) of transactions involving the conversion of equity securities").

officer, director or more-than 10% shareholder. 15 U.S.C. § 78p(b). Unocal seeks disgorgement because Mesa sold Unocal shares within six months of its purchase after becoming a statutory insider by virtue of crossing the 10% ownership line. This section 16(b) claim arises out of Mesa's 1985 attempt to take over Unocal or exact a substantial "greenmail" payment.[4] After having had some success with this strategy in the early 1980's, in 1984 Mesa targeted Unocal and by late February 1985, Mesa had accumulated just below 10% of the outstanding shares of Unocal.[5] Mesa's agent, Boyd Jefferies, disguised Mesa's purchase of an additional 6.7 million shares of Unocal to make it appear that Mesa purchased these shares in a single block trade that would avoid 16(b) liability. In actuality, Mesa crossed the 10% line earlier (and in a series of separate steps) when Jefferies was accumulating the stock on Mesa's behalf.

On April 8, 1985, Mesa made a tender offer to purchase a controlling interest in Unocal at $54 per share. On April 16, Unocal responded by offering to purchase Unocal stock in exchange for senior notes with a par value of $72 per share. Unocal's offer was made to all shareholders except Mesa.[6] The threat of takeover remained, however, so long as Mesa continued to own so much Unocal stock. As the Court of

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[4] It has been judicially determined that Mesa's "principal objective" in purchasing the Unocal stock "was greenmail." *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 952, 956 n.13, 959 (Del. 1985). See also, *Unocal Corp. v. T. Boone Pickens, Jr.*, No. 85-2179, at 13 (C.D. Cal. April 26, 1985) (memorandum decision) ("the Court finds . . . that Mesa II from the outset intended to put Unocal 'in play' and thereby either obtain control or 'greenmail' the corporation . . . . ").

[5] Despite statements in Mesa's original SEC Schedule 13D that its purpose was for "investment" only, Mesa claimed that it had changed its mind on March 28, 1985, when Mesa first announced that it was considering a takeover of Unocal.

[6] Mesa challenged its exclusion and was rebuffed by a decision of the Delaware Supreme Court, which upheld Unocal's tender offer. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 958-59 (Del. 1985).

Appeals pointed out, "The parties dealt at arms length in the negotiations that followed. Unocal was concerned that if the Mesa defendants were excluded, they might buy up the devalued shares at a bargain price and seize control of the corporation." (Pet. at 25a.) After a period of intense settlement negotiations, Unocal and Mesa agreed that Mesa could participate in the Unocal self-tender which allowed Mesa to exchange some of its Unocal stock for senior notes. As a result of Mesa's attempted takeover, Unocal incurred over $4 billion in debt and was substantially harmed.

On May 20, 1985, Mesa sold 7,846,705 shares of Unocal stock to Unocal for senior notes worth $75 per share. Mesa was thus able to sell in May for $75, nearly 8 million shares of stock purchased two months earlier for $48 a share or less. On July 3, 1985, Mesa liquidated the senior notes for some $589 million in cash on the day it received them. With these transactions Mesa closed its greenmail campaign *within six months* of its March 1985 purchases, and, according to Mesa, pocketed a handsome $83 million after-tax profit.

Mesa of course disputes many of the facts which bear upon its section 16(b) "purchase" and which remain for the jury.[7] The only facts that are essential to this appeal, however, are that Mesa exchanged its stock voluntarily for debt instruments (essentially cash)[8] obtained via a tender offer. Mesa negotiated its own terms of sale. Despite Mesa's frequent

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[7] In this procedural posture Unocal is, in any event, entitled to the benefit that all nonessential facts be construed in its favor. *See T.W. Elec. Serv. v. Pacific Elec. Contractors Ass'n*, 809 F.2d 626, 630 (9th Cir. 1987).

[8] Mesa conceded that its exchange of Unocal equity stock for debt securities pursuant to Unocal's self-tender offer was a "sale" if § 16(b) is given literal interpretation. (Pet. at 21a, n.6.) In any event, Mesa exchanged the debt instruments for cash within six months of Mesa's March "purchase" of the Unocal shares at issue.

hyperbole regarding this case being "strikingly parallel to" *Kern*, the plain truth is that unlike the defendant in *Kern*, whose shares were going to be automatically converted to shares of the new entity no matter what it did, Mesa had a variety of options, including simply holding its stock or making a larger tender offer. As noted by the Court of Appeals, citing to Mr. Pickens' own words:

> We had a choice: we could make a deal with Unocal, or after they concluded their tender offer, we could make a 100 percent all-cash offer for the company. We got a call from Drexel asking us not to fold. They had raised $3 billion and were ready to raise the additional funds for us to make a 100 percent offer. It was an unqualified endorsement of Mesa, and it naturally gave us a lift.
>
> It would be a great campaign, no doubt about it, but the risks were getting very high. . . .
>
> * * *
>
> It was time to make a deal.

(Pet. at 25a-26a, quoting *Boone*.)

Mesa argues that its participation in the exchange was not voluntary because Mesa was "economically coerced" since it acted to avoid an alleged "substantial loss." Section 16(b), however, contains no language limiting its application in situations in which the insider acts to avoid a loss.[9] As the

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[9] Although Mesa emphasizes the paper loss that it would have recorded had it been forced to liquidate its investment immediately after Unocal's self-tender without participating in that exchange (which no one was forcing Mesa to do), the fact is that had Mesa merely held on to its Unocal stock until December 1989, the $450 million paper loss that it complains of could have turned into a more than $500 million gain. This billion dollar swing amply demonstrates the unworkability of Mesa's economic rationality test. Federal courts are ill-equipped to take on the additional role of investment banker, especially where to do so would eviscerate what Congress intended to be a simple, bright line test for § 16(b) liability.

Court of Appeals noted in response to Mesa's economic coercion argument: "An economic coercion test would allow corporate insiders to avoid section 16(b) liability by presenting evidence of a variety of unfortunate circumstances that forced them to sell their common stock. The objective standards of section 16(b) were adopted to avoid the necessity for an inquiry into an insider's subjective 'intent'. *Reliance Elec. Co.*, 404 U.S. at 422 (quoting *Bershad*, 428 F.2d at 696)." (Pet. at 29a.)

Mesa filed two summary judgment motions which were initially rejected by the trial court. The first pertained to whether Mesa had crossed the ten percent threshold in a single purchase exempting it from disgorgement under *Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232 (1976), or in a series of steps with Jefferies acting as Mesa's agent. This fact issue remains to be decided by the jury.

On the eve of trial, and in response to the briefing on motions *in limine*, Mesa asked the district court to reconsider its second summary judgment motion, which pertained to the so-called "unorthodox transaction" exception to section 16(b). The parties agreed that the *in limine* motions could be treated as cross motions for summary judgment. On January 19, 1990, the district court granted Mesa's motion in a written opinion that was later amended. Neither opinion is reported. (The amended opinion of April 10, 1990 is found in the Petition at 36a-62a.)

On appeal the Ninth Circuit reversed the granting of summary judgment for Mesa and directed the district court to grant Unocal's motion for partial summary judgment on the inapplicability of the unorthodox transaction exception to this case. That opinion (as amended) is reported at 951 F.2d 1512 (9th Cir. 1991). On December 23, 1991, Mesa's petition for rehearing and rehearing *en banc* was denied.

REASONS FOR DENYING THE WRIT

I.

BACKGROUND AND PURPOSE OF SECTION 16(b)

In section 16(b), Congress enacted a bright-line prophylactic rule of strict liability. Such a rule was deemed necessary in order to curb speculative abuse of inside information and to maintain investor confidence in honest, competitive securities markets. As this Court has emphasized: " 'the *only* method Congress deemed effective to curb the evils of insider trading was a *flat rule* taking the profits out of a class of transactions in which the possibility of abuse was thought to be intolerably great.' " *Kern*, 411 U.S. at 592 (quoting *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 422 (1972)) (emphasis added); see also *Gollust v. Mendell*, ___ U.S. ___, 111 S.Ct. 2173, 2178 (1991) (citing *Reliance*'s "flat rule" language).

Sweeping coverage, strict liability, ease of administration and reduction of difficulties in proof are essential to the achievement of congressional goals:

> In order to achieve its goals, Congress chose a relatively arbitrary rule capable of easy administration. The objective standard of section 16(b) imposes *strict liability* upon substantially all transactions occurring within the statutory time period, *regardless of the intent of the insider or the existence of actual speculation*. This approach maximized the ability of the rule to eradicate speculative abuses by *reducing difficulties in proof. Such arbitrary and sweeping coverage was deemed necessary to insure the optimum prophylactic effect.*

Reliance, 404 U.S. at 422 (quoting *Bershad v. McDonough*, 428 F.2d 693, 696 (7th Cir. 1970)) (emphasis added).

Accordingly, the statute presumes that insiders, including more-than 10% shareholders, have access to nonpublic information that will be used in trading in the company's stock.

See Foremost-McKesson, 423 U.S. at 243, 251; *Reliance*, 404 U.S. at 422. Liability arises "whether fair or unfair"[10] and regardless of the insider's "clean heart,"[11] honorable motive,[12] "good faith,"[13] or lack of scienter,[14] and even though the insider did not in fact engage in any actual speculative abuse whatsoever.[15]

Section 16(b) deliberately adopts an approach that is fundamentally different from that employed under section 10(b) and other areas of federal securities regulation. Market manipulation and actual abuse of inside information are not elements of a section 16(b) "violation." Case-by-case, transaction-by-transaction determinations were eschewed in favor of a flat rule that would (i) be easy to understand and apply, (ii) eliminate difficulties of proof, and (iii) maximize investor confidence. Although this approach might work hardships in

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[10] *E.g.*, *Blau v. Lamb*, 363 F.2d 507, 515 (2d Cir. 1966) (footnote omitted), *cert. denied*, 385 U.S. 1002 (1967); *Oliff v. Exchange Int'l Corp.*, 669 F.2d 1162, 1165-66 (7th Cir. 1980), *cert. denied sub nom. Sax v. Oliff*, 450 U.S. 915 (1981).

[11] *E.g.*, *Allis-Chalmers Mfg. Co. v. Gulf & W. Indus., Inc.*, 527 F.2d 335, 357 (7th Cir. 1975), *cert. denied*, 423 U.S. 1078 & 424 U.S. 928 (1976).

[12] *E.g.*, *Oliff v. Exchange Int'l Corp.*, 449 F.Supp. 1277, 1288 (N.D. Ill. 1978), *aff'd*, 669 F.2d 1162 (7th Cir. 1980), *cert. denied sub nom. Sax v. Oliff*, 450 U.S. 915 (1981); *Rothenberg v. United Brands Co.*, [1977-1978 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 96,045, at 91,690 n.1 (S.D.N.Y. May 11, 1977), *aff'd mem.*, 513 F.2d 1295 (2d Cir. 1977); *Schur v. Salzman*, 365 F.Supp. 725, 728 (S.D.N.Y. 1973).

[13] *E.g.*, *Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F.2d 736, 741 (8th Cir. 1965); *Lane Bryant, Inc. v. Hatleigh Corp.*, 517 F.Supp. 1196, 1198 (S.D.N.Y. 1981).

[14] *E.g.*, *Rothenberg*, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. ¶ 96,045, at 91,690 n.1.

[15] *E.g.*, *Gund v. First Fla. Banks, Inc.*, 726 F.2d 682, 684-87 (11th Cir. 1984); *National Medical Enterprises, Inc. v. Small*, 680 F.2d 83, 84 (9th Cir. 1982); *Oliff*, 669 F.2d at 1165, 1167-68.

particular cases, Congress accepted this fact as a sacrifice necessary to having a general rule.[16]

For those who fail to observe the plain requirements of the statute, the remedy is relatively mild. There is no declaration of wrongdoing. The insider keeps its initial investment, surrendering only short-swing profits made within a six-month period. Moreover, section 16 grants the Securities and Exchange Commission broad power to ameliorate any unwarranted harshness by exempting transactions deemed to fall outside the purposes of the statute. See 15 U.S.C. § 78p(b).

II.

THE COURT OF APPEALS CORRECTLY CONCLUDED THAT THIS CASE FALLS OUTSIDE THE EXCEPTION DEFINED IN *KERN COUNTY*

Mesa asserts that the "facts of this case are overwhelmingly, indeed strikingly, parallel to those of *Kern County*" (Pet. at 12), and that the Court of Appeals ignored and misapplied *Kern*. In truth, the Ninth Circuit faithfully followed standards enunciated by this Court in *Kern* and embraced in the section 16(b) cases ever since.

The Court of Appeals articulated its holding as follows: "We reverse because we have concluded that an exchange of *common stock* for a *negotiable debt security* pursuant to a *tender offer* is a 'sale' within section 16(b)." (Pet. at 7a; emphasis added.)[17] That ruling was dictated by a record that

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[16] In explaining the necessity of such a rule to Congress, Thomas Corcoran, one of the principal drafters of the 1934 Act, stated: "You have to have a general rule. In particular transactions it might work a hardship, but those transactions that are a hardship represent the sacrifice to the necessity of having a general rule." *Hearings on Stock Exchange Practices before the Senate Committee on Banking and Currency*, 73d Cong., 2d Sess. 6557-58 (1934).

[17] In the same vein, the Court of Appeals posed the question for decision in terms of Unocal's contention "that the 'unorthodox transaction defense' to an action brought pursuant to § 16(b) is not applicable to a self-tender offer in which a beneficial owner exchanges his common

(Continued on following page)

conclusively showed that (i) a calculated business decision was made by Mesa to cash out its equity investment by exchanging its stock for notes, (ii) this transaction was part of a tender offer offered to other Unocal shareholders, and (iii) Mesa actively negotiated the terms of the transaction. As the Court of Appeals observed, "[t]he Mesa Defendants had 'the choice of participating in the tender offer or holding onto their stock' " (Pet. at 24a), and "the nature of the Mesa Defendants' investment was changed" (Pet. at 34a) as a result of Mesa's decision to exchange stock for notes with fixed payments and interest rates.

In analyzing these core facts the Ninth Circuit applied long-settled standards derived from *Kern*,[18] from the history and purpose of section 16(b),[19] from the 16(b) cases dealing with changes in the form of a continuing equity investment,[20] and from 16(b) cases pertaining to tender offers, including sales by unsuccessful tender offerors.[21] Notwithstanding Mesa's claims to the contrary, the Court of Appeals manifestly did not hold that Mesa's sale must be subjected to the statute simply because it was not forced pursuant to a merger.

A. The Facts In This Case Are Decisively Different From Those In *Kern County*.

In *Kern*, Occidental's shares were forcibly converted into shares of a successor company in a defensive merger negotiated

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(Continued from previous page)

stock for negotiable debt securities issued as a result of a recapitalization of the issuer." (Pet. at 19a.)

[18] The Court of Appeals reviewed *Kern* in detail. (*Id.* at 22a-24a.) Among other things, the Ninth Circuit cited and relied upon *Kern*'s statement that traditional cash-for-stock transactions are clearly within the purview of § 16(b) (Pet. at 23a) and the fact that *Kern* characterized as "critical" the fact that Occidental's stock was involuntary in the sense that it was required pursuant to a merger. (*Id.* at 24a.)

[19] The Court of Appeals reviewed the history and purpose of § 16(b), particularly as described by this Court in *Kern* and *Reliance*. (*Id.* at 19a-21a.)

[20] *Id.* at 33a-34a.

[21] *Id.* at 30a-32a.

entirely by others. 411 U.S. at 585-87. Not only did Occidental have no control over the merger/forced conversion, it was *literally impossible* for Occidental to continue to hold its stock. The stock was automatically converted by the terms of a merger agreement to which Occidental was not a party, and in which Occidental had no voice. Occidental's only other choice was to sell on the open market in advance of the merger, which itself would have been a section 16(b) sale. Thus, in stark contrast to Mesa, which could have continued holding Unocal shares for more than six months, Occidental would be subject to section 16(b) liability through no volitional act of its own.[22]

The fact that the stock conversion was "required" in the absolute sense was "critical" to this Court's decision to exempt the transaction from the statute:

> The *critical fact* is that the exchange took place and *was required* pursuant to a merger between Old Kern and Tenneco. . . . Occidental obviously *did not participate in or control the negotiations or the agreement* between Old Kern and Tenneco. Once agreement between those two companies crystallized, *the course of subsequent events was out of Occidental's hands.*

Id. at 599 (emphasis added).

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[22] Mesa attempts to finesse this critical distinction by pointing out that the option Occidental obtained from Tenneco was a volitional act, but as this Court stated in *Kern*, "the mere execution of an option is not generally regarded as a 'sale' " for purposes of § 16(b), 411 U.S. at 601 (citations omitted), and the Occidental/Tenneco transaction did not present a cogent reason for altering that rule. *Id.* at 601-02. Furthermore, the date for the exercise of the option in *Kern* was set to occur more than six months from the granting of the option, a period (as noted by this Court in *Kern*) that is assumed to dissipate whatever trading advantage might be imputed to the insider. *Id.* at 603. In sharp contrast, all of the transactions at issue in this case – from the initial purchase by Mesa of Unocal stock to Mesa's exchange of that equity for senior notes, to Mesa's ultimate conversion of those notes to cash – occurred within the six months proscribed by the statute.

In summarizing its holding, *Kern* made clear that the decision was predicated on both the absence of potential for speculative abuse[23] *and* involuntariness:

> We do not suggest that an exchange of stock pursuant to a merger may never result in § 16(b) liability. But *the involuntary nature* of Occidental's exchange, *when coupled with absence of the possibility of speculative abuse* of inside information, convinces us that § 16(b) should not apply to transactions such as this one.

Id. at 600 (emphasis added).[24]

> In contrast, the Court of Appeals noted that, "[u]nlike the plight of the hapless beneficial owner in *Kern County*, the record conclusively shows that the Mesa Defendants voluntarily exchanged their common stock for negotiable debt securities. The exchange in the matter *sub judice* was not the

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[23] Although not necessary to this Court's decision on this petition, it should be mentioned that the seventy-third Congress, which passed the 1934 Act, would almost certainly have regarded Mesa's activities as a species of speculative abuse. Among other things, Mesa's activities included parking arrangements with convicted securities felons that were designed to make it appear that Mesa had successfully avoided § 16(b) (and that also resulted in the violation of other SEC regulations pertaining to net capital requirements). *See Reliance*, 404 U.S. at 428-29 nn. 2 & 3 (Douglas, J., dissenting) (reviewing the legislative history of § 16(b) and noting Congress' concerns with the "pooling" arrangements then prevalent that facilitated stock price manipulation).

[24] As the preeminent treatise on § 16(b) noted in summarizing the case law on this point:

> A few opinions refer only to access to inside information (or a potential for speculative abuse) as the appropriate touchstone, yet the vast majority of the cases correctly conclude that under *Kern County* both factors, involuntariness and no access to inside information, must exist before an unorthodox transaction can escape from being a statutory purchase or sale. This is consistent with – *no, mandated by – Kern* . . . .

Arnold S. Jacobs, *Section 16 of the Securities Exchange Act* § 3.04[5][a], at 3-107 to 3-108 (1989) (footnotes omitted and emphasis added) [hereinafter, "Jacobs"].

> inexorable consequence of corporate machinations that forced the stockholders to exchange their shares as the result of the dissolution of the corporation. Here, the beneficial owners controlled their own destiny and skillfully negotiated a result that Mr. Pickens characterized as a victory for his side."

(Pet. at 27a.) *Kern* also emphasized that Occidental's exchange of stock in "Old Kern" for stock in Tenneco was far removed from the "traditional cash-for-stock transactions" that were "clearly within the purview of § 16(b)." *Kern*, 411 U.S. at 593. Occidental did not exchange its stock for cash or notes, and the nature of its ongoing investment did not change. Stock in the predecessor company was converted into stock of a successor company, *i.e.*, from one form of equity to another form of equity. *Id.* at 586.

As the Court of Appeals noted, Mesa's situation bears no resemblance to the facts that were controlling in *Kern*. (Pet. at 24a-27a.) Among other things:

(1) Mesa's stock was not forcibly or automatically converted.[25]

(2) Far from having its long-term investment interrupted by unanticipated events beyond its control, Mesa specifically anticipated and planned for the prospect of selling stock within six months of the purchase.

(3) Mesa unquestionably could have held its shares,[26] and had complete control over whether and when its shares would be sold.[27]

(4) Mesa exchanged its stock for senior notes with fixed payments and interest rates[28] that were immediately converted to cash,[29] not for stock representing a different form of the same equity investment.[30]

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[25] Pet. at 24a-27a.

[26] *Id.* at 24a.

[27] *Id.* at 11a-12a, 24a-27a, 34a.

[28] *Id.* at 10a, 34a.

[29] *Id.* at 12a.

[30] *Id.* at 33a-34a.

(5) Mesa sold its stock pursuant to a settlement agreement between Mesa and Unocal;[31] the sale was not required by the terms of an agreement between third parties.

(6) The *only* agreement requiring the sale of Mesa's stock was actively and skillfully negotiated by Mesa.[32]

(7) Mesa wielded substantial bargaining power in the negotiations it initiated with Unocal,[33] and Mesa used its leverage to extract substantial concessions from Unocal.[34]

(8) After considering a variety of alternatives available to it,[35] Mesa made a shrewdly calculated business decision to exchange its stock for Unocal notes.[36]

B. Mesa Misstates The Court Of Appeals' Holding And Rationale.

Ignoring these fundamental distinctions from *Kern*, the petition asserts that the Ninth Circuit: "den[ied] the rationale of *Kern County*";[37] "circumscribed *Kern* as merely a 'fact-specific' case";[38] "dismissed a frequently cited statement in *Kern* because this Court 'did not cite any authority to support [it]' ";[39] "confin[ed] *Kern* to mergers";[40] and "conclud[ed] that 'involuntariness' (as narrowly defined by it) was necessary."[41] Thus, according to Mesa, the Ninth Circuit's decision "turns the clock back to pre-*Kern* days and adds substantial confusion to § 16(b) law." (Pet. at 27.)

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[31] *Id.* at 11a-12a.

[32] *Id.* at 11a-12a, 25a-27a, 34a.

[33] *Id.* at 25a-26a.

[34] *Id.* at 26a.

[35] *Id.* at 24a-27a, 34a.

[36] *Id.* at 34a.

[37] *Id.* at 7 n.10.

[38] *Id.*

[39] *Id.*

[40] *Id.* at 26.

[41] *Id.*

None of these claims can be supported. The central premise of Mesa's argument – i.e., the repeated claim that the Court of Appeals held that the unorthodox transaction exception can only be applied when stock is involuntarily converted in a merger – is simply wrong.

Nowhere did the Ninth Circuit purport to limit or confine *Kern* to mergers. On the contrary, the opinion clearly acknowledges that *Kern* is *not* so limited. Among other things, the Court of Appeals expressly stated that "[t]he *majority* of the transactions which have been considered 'unorthodox' within the narrow exception announced in *Kern County* involve exchanges of stock pursuant to a merger." (Pet. at 29a; emphasis added.) Nor did the court hold that the unorthodox transaction exception could *only* be applied to involuntary transactions. What the Court of Appeals *did* state is that "[c]ourts following *Kern County* have recognized that involuntariness *is an important factor in determining*" whether a transaction can escape the provisions of section 16(b). (Pet. at 27a; emphasis added.) No one – not even Mesa – can quarrel with that proposition.

C. The Court of Appeals Did Not Ignore Footnote 24 From *Kern County*.

Mesa's contention that the Ninth Circuit dismissed as "irrelevant" the list of transactions set forth in *Kern*'s footnote 24 (Pet. at 7 n.10, 16) is also incorrect. The Court of Appeals carefully analyzed footnote 24 in response to Mesa's unfortunate mischaracterization of that passage. As the Ninth Circuit recognized, footnote 24 does not purport to specify transactions that are to be exempted from section 16(b) under the *Kern* analysis. It merely lists transactions that lower courts had previously *referred to* via the "term" "unorthodox" for purposes of "inclusion" and "exclusion."

In its entirety, the text to which *Kern*'s footnote 24 is appended reads as follows:

> Although traditional cash-for-stock transactions that result in a purchase and sale or a sale and purchase within the six-month, statutory period are clearly

> within the purview of § 16(b), the courts have wrestled with the question of *inclusion or exclusion* of certain "unorthodox" transactions.

411 U.S. at 593 (emphasis added). And footnote 24 itself merely states:

> The *term*, see 2 L. Loss, Securities Regulation 1069 (2d ed. 1961), *has been applied* to stock conversions, exchanges pursuant to mergers and other corporate reorganizations, stock reclassifications and dealings in options, rights, and warrants.

Id. at 593 n.24 (emphasis added).

The fact that *Kern* did not intend all transactions listed in footnote 24 to be exempted from the statute was further underscored by the statement that, under this Court's holding, even "exchanges pursuant to mergers" may fall outside the exception if they do not meet the articulated standards:

> We do not suggest that an exchange of stock pursuant to a merger may never result in § 16(b) liability. But the involuntary nature of Occidental's exchange, when coupled with the absence of the possibility of speculative abuse of inside information, convinces us that § 16(b) should not apply to transactions such as this one.

Id. at 600.

In response to Mesa's attempt to convert footnote 24 into a list of transactions that must be exempted from section 16(b) under *Kern*, the Court of Appeals noted that (i) footnote 24 was not part of *Kern*'s holding, (ii) footnote 24 merely enumerated, without expressing approval, the types of transactions that other courts had referred to as "unorthodox" and (iii) because no authority was cited it was unclear whether footnote 24 referred to decisions construing section 16(b). (Pet. at 32a-33a.) Thus, rather than "dismissing" footnote 24, the Ninth Circuit analyzed the passage and correctly concluded that Mesa's characterization of it was erroneous.

No court has ever held that *Kern* creates a section 16(b) exemption for all transactions referred to in that footnote. If the Court of Appeals had accepted Mesa's argument, the Ninth Circuit's opinion surely would have introduced confusion into section 16(b) jurisprudence.

III.

THE COURT OF APPEALS' DECISION DOES NOT CONFLICT WITH THE ANALYTICAL APPROACH EMPLOYED BY THIS COURT OR THE SECOND CIRCUIT.

The petition argues that the decision of the Court of Appeals "contravenes the analytical approach" adopted by this Court in *Reves v. Ernst & Young*, 494 U.S. 56 (1990) and *Marine Bank v. Weaver*, 455 U.S. 551 (1982), and by the Second Circuit in *Blau v. Lamb*, 363 F.2d 507 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967); *Mendell v. Gollust*, 909 F.2d 724 (2d Cir. 1990), *aff'd*, ___ U.S. ___, 111 S. Ct. 2173 (1991); *CRA Realty Corp. v. Crotty*, 878 F.2d 562 (2d Cir. 1989) and *International Controls Corp. v. Vesco*, 490 F.2d 1334 (2d Cir.), *cert. denied*, 417 U.S. 932 (1974). (Pet. at 11-12.)

The short answer to this argument is that *Kern* and its progeny establish the appropriate analytical approach with respect to the unorthodox transaction exception. *None* of the cases cited by Mesa involves the unorthodox transaction exception. None conflicts with the analytical approach adopted by the Court of Appeals.[42]

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[42] The petition's citation of snippets from concurring and dissenting opinions in *Reves v. Ernst & Young*, 494 U.S. 56 (1990), is wholly unavailing. *Reves* held that demand notes should be *included* in (not excluded from) the "note" category of securities defined in § 3(a)(10) of the 1934 Act. Neither of the fragments abstracted from the concurring and/or dissenting opinions has any meaningful connection to this case.

Marine Bank v. Weaver, 455 U.S. 551 (1982), held that a certificate of deposit was not a security for purposes of § 10(b) of the 1934 Act – primarily because "the holders of bank certificates are abundantly protected under the federal banking laws." *Id.* at 559.

Mendell v. Gollust, 909 F.2d 724 (2d Cir. 1990), *aff'd*, 111 S.Ct. 2173 (1991), broadened the class of shareholders who have standing to sue under § 16(b). In adopting an expansive construction of the statute that was later affirmed by this Court, the Second Circuit pointedly observed that "[w]hen the statute permits interpretation the section traditionally has been read broadly in view of its remedial purposes." 909 F.2d at 728.

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While it is true that the context clause of the 1934 Act (§ 3(a)) qualifies the Act's statutory definitions with the phrase "unless the context otherwise requires," the context in which this case arises has been thoroughly examined in the decisions applying the unorthodox transaction exception. As is demonstrated herein, those decisions (including the decisions of this Court and the Second Circuit) fully support both the approach and the ruling of the Ninth Circuit here.

IV.

THERE IS NO CONFLICT AMONG THE CIRCUITS; MESA'S ARGUMENTS UNQUESTIONABLY WOULD HAVE MET THE SAME FATE HAD SUIT BEEN FILED ELSEWHERE

The petition cites two cases involving "recapitalizations," and five decisions purportedly pertaining to

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CRA Realty Corp. v. Crotty, 878 F.2d 562 (2d Cir. 1989), dealt with the thorny and esoteric question of who is a corporate officer. The court held that it is the duties of the employee, rather than the label affixed to his position, that determines whether he is an officer. Whether his duties afforded access to inside information was deemed a relevant factor in the "functional" analysis of corporate duties.

International Controls Corp. v. Vesco, 490 F.2d 1334 (2d Cir.), *cert. denied*, 417 U.S. 932 (1974), *expanded* the construction of "sale" for purposes of § 10(b). Although the court's construction was broader than an earlier interpretation of that term in the context of § 16(b), the reason for the minor disparity was the fact that, in contrast to § 16(b), § 10(b) protects the corporation's creditors. *Id.* at 1344-46, 1346 n.15. The decision was based on a peculiarity of § 10(b). It has nothing to do with the unorthodox transaction exception or the proper construction of § 16(b).

Blau v. Lamb, 363 F.2d 507 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967), was decided seven years before *Kern*. It provides no insight into the analytical approach that is appropriate in this case.

involuntariness, as being in conflict with the Ninth Circuit's decision not to exempt Mesa's sale from section 16(b). (Pet. at 18, 20-25.) On that basis, Mesa posits "sharp conflicts" between the Ninth Circuit and the Second, Fourth, Sixth and Eighth Circuits. An examination of the cases Mesa cites quickly demonstrates the absence of any such conflict.

A. Mesa's Reliance On The "Recapitalization" Cases Is Misplaced.

Although Mesa argues that its participation in Unocal's tender offer must be viewed as a "recapitalization," and that recapitalizations are "squarely within the listing enumerated in *Kern*'s footnote 24" (Pet. at 16), footnote 24 does not even list "recapitalizations" among the transactions that purportedly are to be exempted from section 16(b). Nevertheless, Mesa attempts to bootstrap the misconceived "footnote 24" argument it presented to the Court of Appeals into a conflict with the Second Circuit. There is no such conflict.

Mesa did not continue its equity investment. After making a "voluntary business decision" to negotiate an agreement with Unocal (Pet. at 10a), Mesa exchanged Unocal common stock for secured notes in a tender offer extended by Unocal. (Pet. at 10a.) Mesa changed the nature of its investment by liquidating common stock subject to the risks of the stock market in exchange for debt instruments with a significantly higher current value and fixed payments and interest rates. (Pet. at 33a-34a.) Mesa completed its cash-out by converting the notes it received in the tender offer to cash immediately upon receipt. (Pet. at 12a.)

Exchanges pursuant to tender offers – specifically including "self-tenders" by the issuer – are never exempted from section 16(b).[43] Despite Mesa's claim that the Ninth Circuit's

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[43] After surveying the § 16(b) cases, Jacobs' encyclopedic treatise on § 16(b) notes: "A tender offer is a purchase by the tender offeror and a sale by the tendering stockholder, *even if the tender offeror*

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decision conflicts with the law of the Second Circuit, the Second Circuit has made clear that this universal rule applies irrespective of whether the exchange can be characterized as a "recapitalization." *See, e.g., Blau v. Lehman*, 286 F.2d 786, 788-89, 792 (2d Cir. 1960), *aff'd*, 368 U.S. 403 (1962). Similarly, the post-*Kern* decisions of the district courts within the Second Circuit have refused to exempt tender offers from section 16(b). *See, e.g., T-Bar Inc. v. Chatterjee*, 693 F.Supp. 1 (S.D.N.Y. 1988) (self-tender); *Lane Bryant, Inc. v. Hatleigh Corp.*, 517 F.Supp. 1196 (S.D.N.Y. 1981); *Tyco Laboratories, Inc. v. Cutler-Hammer Inc.*, 490 F.Supp. 1 (S.D.N.Y. 1980).

In addition, no case has ever held that an exchange of equity securities for debt instruments[44] can be exempted from section 16(b), again, irrespective of whether such an exchange might be characterized as a "recapitalization." Moreover, since 1966, Securities and Exchange Commission Rule 16b-9, 17 C.F.R. § 240.16b-9 ("Exemption from section 16(b) of transactions involving the conversion of equity securities") has exempted certain transactions in which one *equity* security is exchanged for a substantially equivalent *equity* security. There is no exemption for the conversion of an equity security into a debt instrument.

The basic rationale for exempting certain exchanges of essentially equivalent equity securities was articulated by the Second Circuit in *Blau v. Lamb*: "in a conversion or reclassification . . . that which the insider surrenders and that which he receives are simply different forms of the same participation in his issuer." 363 F.2d at 523. Thus, even if Mesa's "exchange" had not occurred pursuant to a tender offer, it would fall well outside of the scope of both the

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is the issuer [i.e., Unocal]. The conclusion remains unchanged if the tendering shareholder [i.e., Mesa] is a defeated competing offeror tendering to the victorious tender offeror." Jacobs, § 3.04[3], at 3-94 (footnotes omitted and emphasis added).

[44] Convertible debt securities (not involved here) are considered equity securities for purposes of § 16(b), however.

Second Circuit's rationale for exempting certain equity conversions or reclassifications and the SEC's exemption of certain equity conversions in Rule 16b-9.

Curiously, the first recapitalization case cited by Mesa, *Rothenberg v. United Brands Co.*, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,045 (S.D.N.Y. May 11, 1977), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977), is, as the Court of Appeals correctly pointed out, directly contrary to Mesa's position.[45] *Rothenberg* stands for the well-settled proposition "that a recapitalization which results in a change in the nature of a beneficial owner's investment and market risk" is subject to section 16(b). (Pet. at 33a.)

Roberts v. Eaton, 212 F.2d 82 (2d Cir.), *cert. denied*, 348 U.S. 827 (1954), the other Second Circuit recapitalization case cited in the petition, involved a reclassification of common stock. Like *Rothenberg*, *Roberts* involved a stock reclassification that effected no change in the nature of the investment or the risk associated with it. In sharp contrast to Mesa's decision to exchange equity ownership for senior notes, the insider in *Roberts* merely received a different form of the same equity participation in the issuer. Thus, *Roberts* (which was decided before *Kern*) does not create any conflict regarding the proper application of *Kern* to this case.

B. Mesa's Reliance On The Involuntariness Cases Is Misplaced.

The ostensible conflict with the Second, Fourth, Sixth and Eighth Circuits regarding the necessity and meaning of involuntariness is also illusory. First and foremost, the Court of Appeals did not hold that involuntariness is a *necessary* element of the unorthodox transaction exception, or that the unorthodox transaction exception is limited to forced mergers. (See pp. 15-16, *supra*.) Confronted with a record that

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[45] Moreover, *Rothenberg* is not an opinion of the Second Circuit. It is an unpublished (except by CCH in the Federal Securities Law Reporter) district court decision that was affirmed without opinion.

conclusively demonstrates that Mesa changed the fundamental nature of its investment by virtue of its own calculated business decision to participate in Unocal's tender offer, the Court of Appeals concluded that the unorthodox transaction exception was inapplicable. The Ninth Circuit's decision literally cannot create any conflict regarding the necessity of involuntariness. Moreover, even if the Court of Appeals *had* limited the unorthodox transaction exception to involuntary conversions, there would still be no conflict.

The petition cites three appellate decisions in support of Mesa's claim that the circuits are in conflict over whether involuntariness is a necessary element under *Kern: Ferraiolo v. Newman*, 259 F.2d 342 (6th Cir. 1958), *cert. denied*, 359 U.S. 927 (1959); *Petteys v. Butler*, 367 F.2d 528 (8th Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967); and *Gold v. Sloan*, 486 F.2d 340 (4th Cir. 1973), *cert. denied sub nom. Gold v. Scurlock*, 419 U.S. 873 (1974).

Ferraiolo and *Petteys* are pre-*Kern* cases dealing with the conversion of one equity security into another equity security at the apparent behest of the issuer to improve liquidity. In neither case did the fundamental nature of the holder's investment change. Neither case has any meaningful connection with the Court of Appeals' decision. Neither held that involuntariness is not a necessary element under *Kern*.

In addition to citing *Ferraiolo* and *Petteys* as holding that involuntariness is not a necessary element of the unorthodox transaction exception, Mesa cites those cases for the proposition that "economically coerced" transactions are involuntary. (Pet. at 24-25.) *Ferraiolo* and *Petteys* discuss economic coercion – not "involuntariness" under *Kern* – and they have been mooted by *Kern* and its progeny.[46] *Ferraiolo* and *Petteys*

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[46] Footnoting *Ferraiolo* and *Petteys*, the leading treatise on § 16(b) liability explains: "*Some old conversion cases* adopted a less stringent standard – the transaction was voluntary if the defendant could have avoided liability without serious economic detriment – *a standard which*

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are inapposite because they are stock conversion/reclassification cases in which the insider (i) continued to hold the same basic equity investment in the issuer, (ii) did not participate in a tender offer, and (iii) did not negotiate the deal pursuant to which its stock was exchanged.

No post-*Kern* decision has adopted any form of an "economic coercion test." Economic coercion arguments have been resoundingly rejected by the section 16(b) cases,[47] and,

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more recent decisions have rejected." Jacobs, § 3.04[5][a] at 3-111 (footnotes omitted and emphasis added).

In fact the Eighth Circuit, even before *Kern*, eschewed an opportunity to interpret *Petteys* as holding that "economic coercion" brings a transaction outside the strict liability of § 16(b). See *Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F.2d 736 (8th Cir. 1965). There the court held that a sale that was forced pursuant to a government antitrust decree was nevertheless a § 16(b) violation. While there is no case squarely on point in the Sixth Circuit, the little authority there is in no way suggests that that circuit would reach any contrary conclusion on the facts presented here. *See Champion Home Builders Co. v. Jeffress*, 490 F.2d 611, 619 (6th Cir.), ("The record does not show that Jeffress was forced to sell his Champion stock. To the contrary, the record indicates that Jeffress wanted to sell to realize cash . . . . "), *cert. denied sub nom. Jeffress v. Kramer*, 416 U.S. 986 (1974).

[47] *E.g., Heublein, Inc. v. General Cinema Corp.*, 722 F.2d 29, 31 (2d Cir. 1983), (involuntariness under § 16(b) requires complete inability to control terms, conditions and timing of transaction), *cert. denied*, 465 U.S. 1066 (1984); *American Standard, Inc. v. Crane Co.*, 510 F.2d 1043, 1054 (2d Cir. 1974) (involuntariness requires "utter inability . . . to control the course of events"), *cert. denied*, 421 U.S. 1000 (1975); *Oliff*, 669 F.2d at 1167-68 (sale to avoid 205% tax penalty not involuntary); *Western Auto Supply Co.*, 348 F.2d at 742, (sale pursuant to antitrust consent decree not involuntary); *Sprague Electric Co. v. Mostek Corp.*, 488 F.Supp. 842, 844-46 (N.D. Tex. 1980) (sale required by stockholders' agreement not involuntary); *Makofsky v. Ultra Dynamics Corp.*, 383 F.Supp. 631, 638-43 (S.D.N.Y. 1974) (sale to raise cash to avoid defaulting on contractual obligations not involuntary). *See generally* Jacobs,

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as the Court of Appeals noted, any such standard would run directly contrary to the policies underlying the statute. (Pet. at 28a-29a.)[48]

The only issue in *Gold*, the sole case cited as revealing a "conflict" with the Fourth Circuit, was whether an exchange of stock *pursuant to a merger* constituted a *purchase* for purposes of section 16(b):

> The only issue in the cases is whether the exchange by the defendants of their ARC stock for Susquehanna stock pursuant to the merger constituted a "purchase" within the terms of the Act as of the effective date of the merger so as to establish a starting date for measuring the six-month period between purchase and sale of stock by the several defendants.

486 F.2d at 342. Moreover, the Fourth Circuit did not mention, analyze or rule upon the issue of involuntariness.[49]

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§ 3.04[5][a], 3-111 ("An unorthodox transaction is involuntary as to an insider if he has an utter inability to control the terms, condition, or timing of the transaction.") (footnote omitted).

[48] The prospect of case-by-case determination of an infinite variety of unfortunate circumstances that "coerced" corporate insiders to sell their stock is exactly what § 16(b) was designed to avoid. Among other things, the statute expressly provides that profit is to be disgorged "irrespective of any intention on the part of" the insider. 15 U.S.C. § 78p(b).

[49] In *Bunker Ramo-Eltra Corp. v. Fairchild Industries*, 639 F.Supp. 409, 417 (D. Md. 1986), a district court in the Fourth Circuit underscored the invalidity of Mesa's citation of *Gold* as creating a conflict with the Court of Appeals' decision in this case:

> The Supreme Court found in *Kern County* that Occidental's involuntary exchange of stock pursuant to a merger was an unorthodox transaction. The court stated that once a sale and purchase of stock is determined to be an unorthodox transaction, then the question of whether there is actual insider information and resulting insider abuse should be considered.

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Abrams v. Occidental Petroleum Corp., 450 F.2d 157 (2d Cir. 1971), was the appellate decision affirmed in *Kern*. It does not (and could not) create any conflict regarding the proper application of *Kern*, because it does not interpret or apply this Court's decision. In any event, *Abrams* clearly was based on the fact that Occidental "did not arrange" the transaction and was "forced" to participate in it. *Id.* at 162.

Like *Abrams*, *American Standard, Inc. v. Crane Co.*, 510 F.2d 1043 (2d Cir. 1974), *cert. denied*, 421 U.S. 1000 (1975), involved an automatic, nonvolitional sale required by the terms of a merger negotiated by others. *Id.* at 1054-56. The court expressly relied on the "nonvolitional" character of the exchange (*id.* at 1056) and on what the opinion described as *Kern*'s emphasis on "the utter inability of the unsuccessful party to control the course of events." *Id.* at 1054.

Unlike the defendants in *American Standard* and *Abrams* (i.e., *Kern*), Mesa was not faced with a merger or other form of forced conversion. Unlike the defendants in *American Standard* and *Abrams*, Mesa actively negotiated the settlement agreement pursuant to which its Unocal stock was sold and had the option of not selling at all. (Pet. at 24a-27a.)

Mesa had a *variety* of alternatives short of fighting to the end. Mesa could have simply held its stock without making a further tender offer.[50] Mesa also could have negotiated a sale (whether to Unocal or otherwise) that would become effective after expiration of the six-month period prescribed by section

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Defendants' reliance upon *Gold v. Sloan*, 486 F.2d 340 (4th Cir. 1973), *cert. denied*, 419 U.S. 873, 95 S.Ct. 134, 42 L.Ed.2d 112 (1974), to show that the transaction in this case was an unorthodox transaction is misplaced since in *Gold*, there was an exchange of stock pursuant to a merger not a cash transaction as in this case.

[50] If Mesa had held its stock for the "investment purpose" stated in its initial Schedule 13D filed with the SEC, it could have reaped a profit of approximately $532,000,000 through December 1989.

16(b). Moreover, Mesa's alternative of continuing the take-over effort was far from abstract. Drexel Burnham Lambert (Mesa's investment banker) had already raised $3 billion for this purpose. (Pet. at 25a.) Faced with this array of options, Mesa chose to cash out of the investment at an $83,000,000 after-tax profit. (Pet. at 26a-27a.)

C. Mesa's Claim That The Result In This Case Would Have Been Different In The Second Circuit Is Without Merit.

This case plainly would not have been decided differently had it been filed within the Second Circuit. As demonstrated above, *Abrams*, *American Standard*, *Roberts* and *Rothenberg* not only provide no support for Mesa's contrary claim, their reasoning refutes Mesa's argument. Moreover, other decisions of the Second Circuit demonstrate that this case would have been decided no differently had the action been filed in that jurisdiction. In *Perine v. William Norton & Co.*, 509 F.2d 114 (2d Cir. 1974) (decided before this Court's decision in *Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232 (1976)), for example, an underwriter which, pursuant to a firm-commitment underwriting became a more-than 10% shareholder of the issuer, and which then sold those shares pursuant to the underwriting, argued that liability under section 16(b) should not apply because it had no access to inside information. The Second Circuit made short work of this contention:

> Without the possibility of its having had prior access to inside information, [appellant] argues, the distribution did not present the potential for abuse that is inherent in short-term transactions by insiders. *See Kern County Land Co. v. Occidental Petroleum Corp.*, *supra*, 411 U.S. at 594-595.
>
> Were it not for the plain language of § 16(b) and the established policy in favor of mechanical application of that language, *see Reliance Electric Co. v. Emerson Electric Co.*, *supra*, [appellant's] argument might be persuasive. But § 16(b) provides in sweeping and unequivocal terms that "*any* profit

> realized by [such beneficial owner] from *any* purchase and sale . . . of *any* equity security of such issuer . . . within *any* period of less than six months . . . shall . . . be recoverable by the issuer, irrespective of *any* intention on the part of such beneficial owner . . . in entering into such transaction . . . (emphasis supplied).

Perine, 509 F.2d at 117-18 (emphasis in original).[51]

In applying *Kern* and the unorthodox transaction exception, the Second Circuit requires involuntariness in the absolute sense that was decisive in *Kern* – not merely facts indicating that the insider had no access to inside information:

> We believe that Judge Conner's decision below accurately states and applies the law of both the Supreme Court case, *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 93 S.Ct. 1736, 36 L.Ed.2d 503 (1973), and this circuit's decision in *American Standard, Inc. v. Crane Co.*, 510 F.2d 1043 (2d Cir. 1974), *cert. denied*, 421 U.S. 1000, 95 S.Ct. 2397, 44 L.Ed.2d 667 (1975), and we find his well reasoned opinion persuasive. . . . We read Judge Conner's opinion to mean that in the *class* of cases of which the present case is representative, *where* (1) an atmosphere of suspicion, if not hostility, characterizes relations between the two corporations, (2) *the exchange of shares is "involuntary" in that it is effectuated pursuant to a*

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[51] The court also emphasized *Reliance* and *Kern*'s repeated references to the prophylactic presumptions that Congress mandated and that have been featured in § 16(b) jurisprudence:

> Making administration of the statutory scheme simple, Congress adopted a prophylactic measure which permits recovery by the corporation of the profits from a class of insider transactions in which "the possibility of abuse was believed [by Congress] to be intolerably great", *i.e.*, purchases and sales by an insider within six months, *Reliance Electric Co., supra*, 404 U.S. at 422, "without proof of actual abuse of insider information, and without proof of intent to profit on the basis of such information", *Kern*, 411 U.S. at 595."

Perine, 509 F.2d at 117.

> *merger* over which the investing corporation exercised no control or influence, *and* (3) there is no likelihood of access to material inside information, § 16(b), the "paradigmatic strict liability statute," is inappropriate and will not apply.

Heublein, Inc. v. General Cinema Corp., 722 F.2d 29, 31 (2d Cir. 1983) (first emphasis in the original), *cert. denied*, 465 U.S. 1006 (1984).

Three district court cases decided within the Second Circuit have rejected Mesa's argument that *Kern* exempts transactions in which an unsuccessful tender offeror sells its stock within six months of a purchase while contending that it had no access to inside information. *T-Bar Inc. v. Chatterjee*, 693 F.Supp. 1 (S.D.N.Y. 1988); *Lane Bryant, Inc. v. Hatleigh Corp.*, 517 F.Supp. 1196 (S.D.N.Y. 1981); *Tyco Laboratories, Inc. v. Cutler-Hammer, Inc.*, 490 F.Supp. 1 (S.D.N.Y. 1980). Each of these cases was decided on the basis of *Kern* and the law of the Second Circuit. Each was cited and relied upon in the decision of the Court of Appeals. (Pet. at 30a-31a.)

V.

THERE IS NO REASON TO CREATE ANY SPECIAL SECTION 16(b) EXEMPTION FOR DEFEATED TENDER OFFERORS AND "GREENMAILERS."

The courts applying *Kern* have repeatedly and uniformly rejected the "defeated tender offeror" argument advanced by Mesa. As Jacobs notes: "Because a contest for control was *Kern County*'s factual origin, defeated contestants who sold otherwise than through such a merger have attempted to argue that *Kern County* also governs their sale, and therefore their sale is unorthodox. *These arguments have proved unavailing.*" Jacobs, § 3.04[5][d], at 3-145 (emphasis added). In addition to the decisions within the Second Circuit, the other circuit courts confronted with claims of unorthodoxy in the defeated tender offeror situation (based in substantial part upon assertions of hostility and consequent lack of access to inside information) have all concluded that the *Kern* exception did not apply. *See, e.g., Super Stores Inc. v. Reiner*, 737 F.2d 962

(11th Cir. 1984); *Texas Int'l Airlines v. National Airlines, Inc.*, 714 F.2d 533 (5th Cir. 1983), *cert. denied*, 465 U.S. 1052 (1984).

Since 1934, the SEC has had express authority to create exceptions to the statute's literal terms *if* in the opinion of the Commission the class of transactions is "not comprehended within the purpose of" section 16(b). 15 U.S.C. § 78p(b). Not surprisingly, neither the Commission nor Congress has sought to disturb the courts' consistent application of section 16(b) to volitional sales by unsuccessful tender offerors.

After a statute has been construed "by a consistent course of decision by other federal judges and agencies, it acquires a meaning that should be as clear as if the judicial gloss had been drafted by Congress itself." *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220, 268 (1987) (Stevens, J., concurring in part and dissenting in part). The interpretation of a statute by the agency charged with administering it is entitled to considerable deference. *See, e.g., Griggs v. Duke Power Co.*, 401 U.S. 424, 433-34 (1971); *Udall v. Tallman*, 380 U.S. 1, 16 (1965). Such deference extends to an agency's decision not to act, *Heckler v. Chaney*, 470 U.S. 821, 834 (1985), and is especially appropriate when Congress has declined to alter an administrative construction. *Red Lion Broadcasting v. FCC*, 395 U.S. 367, 381 (1969).

Entirely apart from questions of judicial deference and upsetting settled expectations, there is no principled reason why a hostile tender offeror should be exempted from the statute. This is particularly true when all others, many of whom are in an equally plausible position to argue economic coercion and lack of access to inside information, are subject to this bright-line, prophylactic rule of strict liability.

Section 16(b) was directed at (among other things) short-swing profits made by those who "manipulate the market price of their corporation's shares by causing the corporation to inaugurate and follow financial policies calculated to produce sudden fluctuations in that price." *Arrow Distribution Corp. v. Baumgartner*, 783 F.2d 1274, 1277-78 (5th Cir. 1986); *accord Blau v. Lamb*, 363 F.2d 507, 514-15 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967). The greenmail

profits garnered via this sort of market manipulation by hostile tender offerors should not be removed from the sweeping coverage mandated by Congress.

CONCLUSION

For all of the foregoing reasons, the petition for a writ of certiorari should be denied.

DATED: April 24, 1992

Respectfully submitted,

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Supreme Court, U.S.
FILED
APR 30 1992
OFFICE OF THE CLERK

(3)

No. 91-1451

IN THE

Supreme Court of the United States

October Term, 1991

MESA PETROLEUM CO., et al.,

Petitioners,

v.

DAVID COLAN and UNOCAL CORPORATION,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITIONERS' REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

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April 29, 1992

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PETITIONERS' REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

Unocal's Opposition (cited herein as "Opp. at __") would have this Court believe that the Ninth Circuit's decision poses no conflicts with this Court's decision in *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973), nor with the numerous decisions of the Second and other Circuits cited in the Petition. The conflicts are real, and §16(b) law will be left in substantial confusion unless the writ is granted.

Kern County is universally regarded as a landmark case in securities law jurisprudence, and the Ninth Circuit should not be permitted to undercut so important a precedent. *Kern* and this case are not distinguishable in any material factual respect. But even if *Kern* were "factually distinguishable," it is far more important that the two cases are not distinguishable *legally*.

Contrary to Unocal's suggestion, it is well settled, particularly after *Kern*, that "mechanical" application of §16(b)'s "flat rule" is limited to "garden variety" transactions. Transactions that are not garden variety — which this Court labeled "unorthodox" or "borderline," 411 U.S. at 593, 594 — are considered statutory "sales" under §16(b) *only* if they present an opportunity for the speculative abuse of inside information — the sole evil addressed by the statute. *Id.*

Mesa's petition presents the single question whether its economically coerced exchange of Unocal stock for Unocal bonds pursuant to Unocal's recapitalization was a "sale" for purposes of §16(b).[1] The district court held first that Mesa's exchange was unorthodox rather than garden variety and second that that

[1] Unocal nonetheless talks at length about Mesa's *purchase* of Unocal stock, including unsubstantiated accusations of "greenmail," "parking," "disguised" purchases and "arrangements with convicted securities felons." Opp. at 3-4, 12, 28-29. As Unocal admits, these accusations are both irrelevant to the question before this Court and disputed by Mesa. Opp. at 4.

unorthodox transaction was not a §16(b) "sale," since it did not present Mesa with any opportunity to abuse inside information. The Ninth Circuit reversed, with a categorical holding that the exchange was *not* an unorthodox transaction because it was neither "involuntary" nor pursuant to a merger. The Ninth Circuit then concluded that it need not even consider the issue of whether Mesa had the opportunity to abuse inside information.[2]

Contrary to Unocal's assertions, the Ninth Circuit's opinion undermines *Kern* in several respects. It tries to limit *Kern's* effect to the specific facts of that case (Pet. at 22a) and confines the unorthodox transaction approach to an "involuntary transaction that results from a merger." Pet. at 29a. In so doing, the Ninth Circuit (1) ignores the basic thrust of *Kern*, which is to analyze whether the nature and circumstances of the transaction in question presented an opportunity for abuse of inside information by the particular defendant and (2) dismisses as irrelevant *Kern's* oft-cited footnote 24, which lists illustrative types of transactions (in addition to mergers) that are not garden variety.

Moreover, the Ninth Circuit's decision exacerbates a conflict among the Circuits as to whether *Kern* requires involuntariness as an essential element in holding a transaction to be outside the scope of §16(b). In addition, insofar as involuntariness is to be considered in the analysis (whether or not as an essential element), the Ninth Circuit's decision exacerbates a conflict among the Circuits as to what constitutes involuntariness. The conflicts are particularly sharp between the Ninth Circuit's decision in this case and several decisions of the Second Circuit.[3]

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[2] Not once does Unocal even suggest that Mesa's exchange could have conceivably provided Mesa with any opportunity to abuse inside information about Unocal (even if Mesa had had access to any such information, which Unocal concedes is not the case).

[3] Unocal asserts that *Kern's* "principles have been *consistently* applied in a myriad of decisions throughout the federal judiciary . . . ." Opp. at 2 (emphasis supplied). The author of the §16(b) treatise on which

Unocal's Section II — Conflicts With *Kern*.

The Ninth Circuit's Limitation of *Kern* to Mergers. Unocal attempts to avoid the collision with *Kern* by repeatedly arguing that the Ninth Circuit did *not* limit the unorthodox transaction analysis to involuntary exchanges pursuant to mergers.[4] Unocal's palliative assertions cannot be reconciled with the words of the Ninth Circuit's express holding: "We conclude that the facts in this matter do not come within the holding of *Kern County* that [1] an *involuntary* transaction [2] that results from a *merger* is 'unorthodox.'" Pet. at 29a (emphasis and brackets supplied). Nor can Unocal's characterizations be squared with numerous other passages in the Ninth Circuit's opinion. *See, e.g.*, Pet. at 24a (Mesa's exchange "not an involuntary or automatic transaction" compelled by merger); 27a ("not the inexorable consequence of corporate machinations that forced the stockholders to exchange their shares . . . "); 29a ("*Kern County* simply held that an automatic exchange . . . pursuant to a merger" is outside § 16(b)).[5]

***Kern's* Footnote 24.** Contrary to Unocal's characterization (Opp. at 15-16), Mesa does not argue that inclusion of a type of transaction in *Kern's* footnote 24 is by itself sufficient to exclude a transaction from § 16(b). Only those "unorthodox" transactions

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Unocal repeatedly relies, however, disagrees. *See* A. Jacobs, *Section 16 of the Securities Exchange Act* §3.04[5][a] at 3-107 (1989) (observing that courts have adopted inconsistent approaches in applying the unorthodox transaction doctrine "[b]ecause all judges do not read *Kern County* the same way").

[4] *See, e.g.*, Opp. at 15 (did not "purport to limit or confine *Kern* to mergers"; did not hold "unorthodox transaction exception could *only* be applied to involuntary transactions"); 21 ("did not hold that involuntariness is a *necessary* element of the unorthodox transaction exception, or that the unorthodox transaction exception is limited to forced mergers") (emphasis in original).

[5] As to Unocal's citation (Opp. at 15) to the Ninth Circuit's statement that the "majority" of the unorthodox transaction cases involve mergers, see Pet. at 16 n.23.

which present no opportunity for speculation based on inside information fall outside § 16(b)'s scope. Footnote 24 was this Court's listing of the kinds of "unorthodox" or "borderline" transactions — as distinguished from "garden variety" or "traditional cash-for-stock" purchases and sales — that federal courts had theretofore analyzed and that, according to this Court, *should* be analyzed to determine whether or not they provide an opportunity for such speculation. *See* Pet. at 15-16. Unocal suggests (without authority) that *Kern's* footnote 24 was not intended by this Court to have any significance. Opp. at 15. But the lower courts have taken footnote 24 as a basic reference point for the "unorthodoxy" analysis, while recognizing that the list is not exhaustive or all-inclusive. *See* Pet. at 16-17.[6] We are aware of no opinion, other than the Ninth Circuit's opinion here, that simply brushes aside the footnote as irrelevant.

Factual Parallels with *Kern*. Unocal sets forth an eight-point list of supposed factual differences from *Kern*. Opp. at 13-14. Half of the items — nos. (1), (3), (5) and (6) — relate to the "involuntariness" issue, which is addressed below and in the Petition.[7] Each of the other suggested distinctions (numbered here as in Unocal's list) is either legally irrelevant, unsupported by the record or based on a misreading of *Kern:*

> (2) The allegation that Mesa planned for a short-term investment is both unsupported by the record (as evidenced

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[6] Jacobs notes that "lower courts have adopted footnote 24 as a statement of law," Jacobs, § 3.04[2] at 3-75, and that "[t]he best test is to include within 'unorthodox transactions' those transactions in footnote 24 of *Kern County*, as we have added to them . . . . " *Id.* at 3-77.

[7] Unocal's footnote 22 (Opp. at 11 n.22) completely evades the principal focus of *Kern's* discussion of the Occidental/Tenneco option. *Kern* clearly held that the option — an entirely voluntary transaction — was not a "sale" by virtue of the unorthodox transaction analysis. *Kern*, 411 U.S. at 601-04; *see also* Pet. at 14. Unocal's footnote 22 erroneously suggests that the alternative basis for the Court's holding on the option (i.e., that it did not constitute a sale in fact) was the only basis.

by Unocal's failure to cite any authority) and legally irrelevant. *See Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 422 (1972).

(4) Unocal nowhere explains why there is a meaningful distinction between Occidental's exchange of common stock for preferred stock in an entirely different company and Mesa's exchange of stock for debt securities issued by the same company.

(7) Claims of Mesa's "substantial bargaining power" and "leverage" used to "extract substantial concessions" are unsupported by Unocal's authority and are directly contradicted by the record. *See* Pet. at 54a. Moreover, this Court observed in *Kern* that if Occidental had leverage in dealing with Tenneco, it was irrelevant since it was attributable to Occidental's "large stock ownership itself," not to "inside information." 411 U.S. at 602.

(8) A "shrewdly calculated business decision" was also made by Occidental. *See* Pet. at 13-14.

The facts of this case are not different in any material respect from those of *Kern*. *See* Pet. at 12-15.

Unocal's Section IV — Conflicts With Other Circuits.

Recapitalizations and Tender Offers. The unorthodox transaction approach does not require that the recapitalization cases cited by the parties be analyzed to determine the precise similarities and differences between Unocal's recapitalization and the ones in those cases.[8] The point is simply that, under *Kern's*

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[8] Contrary to Unocal's assertion (Opp. at 19), however, Mesa *did* continue its equity investment in Unocal. Following the Exchange Offer (which applied to about one-third of a holder's total shares), Mesa's ownership percentage of the reduced number of total outstanding Unocal shares was essentially the same as it was before the transaction (about 13.6%). Pet. at 40a. Also, contrary to Unocal's

footnote 24 and decisions of the Second Circuit (*see* Pet. at 17-18), an exchange pursuant to a recapitalization is not a garden variety transaction and must therefore be analyzed to determine whether the defendant had an opportunity for speculative abuse.[9] Whether a recapitalization results in a "change in the nature of the investment" (an imprecise phrase, at best) is a red herring. In *Kern* itself, as noted above, the nature of Occidental's investment fundamentally changed.[10] *See* Pet. at 17 n.26.

The cases do not support Unocal's purported "universal rule" that exchanges in tender offers are always § 16(b) sales (Opp. at 19-20) — as evidenced by Unocal's lack of case law support therefor.[11] In fact, the Ninth Circuit acknowledged that an exchange in a tender offer had been held unorthodox. Pet. at 31a.

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assertion (Opp. at 20), the Exchange Offer, did involve what the Second Circuit described in *Blau v. Lamb*, 363 F.2d 507, 523 (2d Cir. 1966) (cited with approval in *Kern*, 411 U.S. at 594 n.26), *cert. denied*, 385 U.S. 1002 (1967), as a recapitalization: "that which the insider surrenders and that which he receives are simply different forms of the same participation in his issuer."

[9] The Jacobs treatise, which Unocal cites so frequently, agrees: Recapitalizations are unorthodox transactions, Jacobs, § 3.04[5][f] at 3-177, which do not give rise to § 16(b) liability as long as "all stockholders are treated equally and receive a security of the company in which they had invested." *Id.* at 3-186.

[10] Unocal is wrong in asserting (Opp. at 20) that "no case has ever held that an exchange of equity securities for debt instruments" is within the unorthodox transaction doctrine. *Hayes v. Sampson*, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,693 (S.D.N.Y. 1980) (cited in Pet. at 18), so held as to a recapitalization involving an exchange of convertible debt securities (which are equity securities under § 16(b); *see* Opp. at 20 n.44) for non-convertible debt securities.

[11] The only Court of Appeals decision that Unocal cites in its effort to demonstrate such a rule is *Blau v. Lehman*, 286 F.2d 786 (2d Cir. 1960), *aff'd*, 368 U.S. 403 (1962), but even if the recapitalization transaction there could be labeled a tender offer (which is not clear from the opinion), it involved no economic coercion or other involuntariness. Neither *Lane Bryant, Inc. v. Hatleigh Corp.*, 517 F. Supp. 1196 (S.D.N.Y. 1981), nor *Tyco Laboratories, Inc. v. Cutler-Ham-*

Involuntariness. The Ninth Circuit concluded that Mesa's exchange was "voluntary" because (1) Mesa "voluntarily" negotiated to overcome Unocal's discrimination against it and to obtain permission to participate in the Exchange Offer, (2) Mesa had the "alternative" of mounting a larger tender offer and (3) having obtained permission to participate in the economically coercive Exchange Offer, Mesa "voluntarily" tendered its shares. The Petition demonstrates the conflicts that the Ninth Circuit's decision poses with *Kern* and with decisions of other Circuits on each of these three indicia of "voluntariness."

With respect to the first, the Opposition completely ignores the Ninth Circuit's conflicts with *Kern County* and with *Colan v. Continental Telecom, Inc.*, 616 F. Supp. 1521 (S.D.N.Y. 1985), *aff'd without opinion*, 788 F.2d 2 (2d Cir. 1986), under both of which Mesa's "negotiations" are irrelevant. *See* Pet. at 23. As to the second type of "voluntariness," Unocal's discussion of *Abrams v. Occidental Petroleum Corp.*, 450 F.2d 157 (2d Cir. 1971), *aff'd sub nom. Kern County*, and *American Standard, Inc. v. Crane Co.*, 510 F.2d 1043 (2d Cir. 1974), *cert. denied*, 421 U.S. 1000 (1975) (Opp. at 25-26), does not respond to the fact that the Second Circuit held in each case that the alternative of making another tender offer is irrelevant.[12] *See* Pet. at 23-24.

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mer, Inc., 490 F. Supp. 1 (S.D.N.Y. 1980), involved a sale in a tender offer; each involved a sale in a transaction available only to the defendant, who happened to be a defeated corporate suitor.

[12] Unocal also invents two other irrelevant "alternatives" that Mesa supposedly had. Opp. at 25-26; *see also* Opp. at 5 n.9. First, Unocal argues that Mesa could have avoided the loss imposed by nonparticipation in the Exchange Offer if it had held its stock for 4½ years, a period selected by Unocal. As the District Court concluded (on a point the Ninth Circuit did not address), hindsight should not be applied to determine whether a statutory insider would have realized a better or worse financial outcome if it had held its stock for any particular period beyond the statutory six months; a court applying § 16(b) must be concerned with the facts as they existed at the time the decision in question was made. Pet. at 53a. Second, Unocal claims (without any support in the record) that Mesa could have

Regarding the Ninth Circuit's conflict with other Circuits as to whether economic coercion makes a transaction that is voluntary in form "involuntary" for purposes of § 16(b) (*see* Pet. at 24-25), Unocal's response is inconsistent and misleading. First, immediately after claiming that *Kern* "mooted" the pre-*Kern* cases of *Ferraiolo v. Newman,* 259 F.2d 342 (6th Cir. 1958), *cert. denied,* 359 U.S. 927 (1959), and *Petteys v. Butler,* 367 F.2d 528 (8th Cir. 1966), *cert. denied,* 385 U.S. 1006 (1967) — two of the five cases that were specifically cited with approval in *Kern's* footnote 26; *see* Pet. at 19 — Unocal twice cites another pre-*Kern* case that is favorable to Unocal's position regarding economic coercion. Opp. at 23 nn.46 & 47 (citing *Western Auto Supply Co. v. Gamble-Skogmo, Inc.,* 348 F.2d 736 (8th Cir. 1965), *cert. denied,* 382 U.S. 987 (1966)). *Western Auto,* which was not cited at all in *Kern,* is simply further evidence of the conflict among the Circuits.[13] Unocal then asserts that two decisions of the Second Circuit have "resoundingly rejected" economic coercion arguments. Opp. at 23 (citing *Heublein, Inc. v. General Cinema Corp.,* 722 F.2d 29 (2d Cir. 1983), *cert. denied,* 465 U.S. 1066 (1984), and *American Standard).* Neither case had anything to do with economic coercion; both were merger cases in which *Kern* was applied.

Second Circuit Cases. Unocal's excerpt from *Perine v. William Norton & Co.,* 509 F.2d 114 (2d Cir. 1974) (Opp. at 26-27), is out of context. *Perine* in fact supports Mesa's argument and further evidences the conflict between the Ninth Circuit's holding

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negotiated a sale within the six-month period that would have somehow "become effective" thereafter. It is well settled that §16(b) liability cannot be avoided by such a formalistic device. *See, e.g.,* §3(a)(14) of the 1934 Act ("sale" includes a contract to sell); *Bershad v. McDonough,* 428 F.2d 693 (7th Cir. 1970), *cert. denied,* 400 U.S. 992 (1971).

[13] *Western Auto* could not have "eschewed an opportunity" to interpret *Petteys* differently (as Unocal claims; Opp. at 23 n.46), since *Western Auto* was decided prior to *Petteys.*

here and the jurisprudence of the Second Circuit. In *Perine*, the Second Circuit, because of the absence of opportunity for abuse, held that the underwriter's sale was exempted by Rule 16b-2, 17 C.F.R. § 240.16b-2, 509 F.2d at 121 — despite the fact that the exemption would not be available if the Rule were applied literally. *Id.* at 119.

Unocal's quotation from *Heublein* (Opp. at 27-28) also further supports Mesa's position and further evidences the conflicts with the Second Circuit. The only difference between the three conditions listed in the *Heublein* quotation and the facts of this case is that an exchange in a merger is involuntary in form as well as substance, while Mesa's exchange in the economically coercive Exchange Offer was involuntary in substance but not form.[14]

Unocal's Section V — Defeated Tender Offerors.

Unocal's Section V creates a straw man. The Petition does not assert that Mesa's exchange was exempt from § 16(b) solely by virtue of the fact that Mesa was a defeated tender offeror. Mesa's argument — and the cases cited in its Petition that conflict with the Ninth Circuit's decision — turn on the nature of the *transaction*, as well as the status of the defendant. *See* Pet. at 20-21.[15]

Unocal also asserts that the failure of the Securities and Exchange Commission to promulgate a rule exempting transac-

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[14] None of the three district court cases cited at Opp. at 28 involved economic coercion or any other kind of "involuntariness."

[15] Interestingly, however, the Jacobs § 16(b) treatise advocates a far broader "exemption" than the one Unocal attributes to Mesa's advocacy. Noting that § 16(b)'s sole purpose "is to prevent insiders from using inside information unfairly," Jacobs observes that "[a]n insider cannot unfairly use inside information if he can control the transaction but has no access to inside information, nor can he unfairly use inside information if he has access yet cannot control the transaction." Jacobs, § 3.04[5][a] at 3-108. Jacobs therefore concludes that "the better view is to deem an unorthodox transaction to be a Section 16(b) purchase or sale unless, as to the insider, the transaction was involuntary *or* he had no access to inside information." Jacobs, § 3.04[5][b] at 3-130 (emphasis in original).

tions such as this one from the coverage of § 16(b) is determinative. Opp. at 29. If Unocal's argument were correct, every case that has held an unorthodox transaction to be outside of § 16(b) (including *Kern County*) would be wrong. Indeed, since 1952 and well before *Kern*, a Commission rule has exempted dispositions pursuant to certain kinds of mergers. Rule 16b-7, 17 C.F.R. § 240.16b-7. Yet the disposition pursuant to the merger at issue in *Kern* was held not to be a § 16(b) "sale," even though the *Kern* merger was *not* within the coverage of Rule 16b-7.

Conclusion

For the reasons set forth above and in the Petition, the writ of certiorari should be granted.

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April 29, 1992